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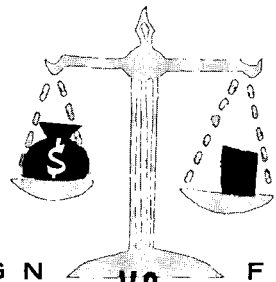
HENRY HAZLITT



FOREIGN INVESTMENT VS. FOREIGN AID

AT the beginning of Chapter III of his *History of England,* Thomas Babington Macaulay wrote:

"In every experimental science there is a tendency toward perfection. In every human being there is a wish to ameliorate his own condition. These two principles have often sufficed, even when counteracted by great public calamities and by bad institutions, to carry civilization rapidly forward. No ordinary misfortune, no ordinary misgovernment, will do so much to make a nation wretched as the constant effort of every man to better himself will do to make a nation prosperous. It has often been found that profuse expenditures, heavy taxation, absurd commercial restrictions, corrupt tribunals, disastrous wars, seditions, persecutions, conflagrations, inundations, have not been able to destroy capital so fast as the exertions of private citizens have been able to create it. It can easily be proved that, in our own land, the national wealth has, during at least six centuries, been almost uninterruptedly increasing. . . . This progress, having continued during many ages, became at length, about the middle of the eighteenth century, portentously rapid, and has proceeded, during the nineteenth, with accelerated velocity."

We too often forget this basic truth. Would-be humanitarians speak constantly today of "the vicious circle of poverty." Poverty, they tell us, produces malnutrition and disease, which produce apathy and idleness, which perpetuate poverty; and no progess is possible without help from outside. This theory is today propounded unceasingly, as if it were

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Henry Hazlitt is well-known to FREEMAN readers as author, columnist, editor, lecturer, and practitioner of freedom. This article will appear as a chapter in a forthcoming book, *The Conquest of Poverty,* to be published by Arlington House.

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axiomatic. Yet the history of nations and individuals shows it to be false.

It is not only "the natural effort which every man is continually making to better his own condition" (as Adam Smith put it even before Macaulay) that we need to consider, but the constant effort of most families to give their children a "better start" than they enjoyed themselves. The poorest people under the most primitive conditions work first of all for food, then for clothing and shelter. Once they have provided a rudimentary shelter, more of their energies are released for increasing the quantity or improving the quality of their food and clothing and shelter. And for providing tools. Once they have acquired a few tools, part of their time and energies can be released for making more and better tools. And so, as Macaulay emphasized, economic progress can become accelerative.

One reason it took so many centuries before this acceleration actually began, is that as men increased their production of the means of subsistence, more of their children survived. This meant that their increased production was in fact mainly used to support an increasing population. Aggregate production, population, and consumption all increased; but per capita production and consumption barely increased at all. Not until the Industrial Revolution began in the late eighteenth century did the rate of production begin to increase by so much that, in spite of leading to an unprecedented increase in population, it led also to an increase in per capita production. In the Western world this increase has continued ever since.

So a country can, in fact, starting from the most primitive conditions, lift itself from poverty to abundance. If this were not so, the world could never have arrived at its present state of wealth. Every country started poor. As a matter of historic fact, most nations raised themselves from "hopeless" poverty to at least a less wretched poverty purely by their own efforts.

Specialization and Trade

One of the ways by which each nation or region did this was by division of labor within its own territory and by the mutual exchange of services and products. Each man enormously increased his output by eventually specializing in a single activity – by becoming a farmer, butcher, baker, mason, bricklayer, or tailor – and exchanging his product with his neighbors. In time this process extended beyond national bound-

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aries, enabling each nation to specialize more than before in the products or services that it was able to supply more plentifully or cheaply than others, and by exchange and trade to supply itself with goods and services from others more plentifully or cheaply than it could supply them for itself.

But this was only one way in which foreign trade accelerated the mutual enrichment of nations. In addition to being able to supply itself with more goods and cheaper goods as a result of foreign trade, each nation supplied itself with goods and services that it could otherwise not produce at all, and of which it would perhaps not even have known the existence.

Thus foreign trade *educates* each nation that participates in it, and not only through such obvious means as the exchange of books and periodicals. This educational effect is particularly important when hitherto backward countries open their doors to industrially advanced countries. One of the most dramatic examples of this occurred in 1854, when Commodore Perry at the head of a U. S. naval force "persuaded" the Japanese, after 250 years of isolation, to open their doors to trade and communication with the U.S. and the rest of the world. Part of Perry's success, significantly, was the result of bringing and showing the Japanese such things as a modern telescope, a model telegraph, and a model railway, which delighted and amazed them.

Some Steps May Be Skipped

Western reformers today, praising some hitherto backward country, in Africa or Asia, will explain how much smarter its natives are than we of the West because they have "leaped in a single decade from the seventeenth into the twentieth century." But the leap, while praiseworthy, is not so surprising when one recalls that what the natives mainly did was to import the machines, instruments, technology, and know-how that had been developed during those three centuries by the scientists and technicians of the West. The backward countries were able to bypass home coal furnaces, gaslight, the street car, and even, in most cases, the railroad, and to import Western automobiles, Western knowledge of road-building, Western airplanes and airliners, telephones, central oil heaters, electric light, radio and television, refrigerators and air-conditioning, electric heaters, stoves, dishwashers and clothes washers, machine tools, factories, plants, and Western technicians, and then to send some of their youth to Western colleges and uni-

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versities to become technicians, engineers, and scientists. The backward countries imported, in brief, their "great leap forward."

In fact, not merely the recently backward countries of Asia and Africa, but every great industrialized Western nation, not excluding the United States, owes a very great part – indeed, the major part – of its present technological knowledge and productivity to discoveries, inventions, and improvements imported from other nations. Notwithstanding the elegant elucidations by the classical economists, very few of us today appreciate all that the world and each nation owes to foreign trade, not only in services and products, but even more in knowledge, ideas, and ideals.

International Investment

Historically, international trade gradually led to international investment. Among independent nations, international investment developed inevitably when the exporters of one nation, in order to increase their sales, sold on short-term credit, and later on longer-term credit, to the importers of another. It developed also because capital was scarcer in the less developed nation, and interest rates were higher. It developed on a larger scale when men emigrated from one country to another, starting businesses in the new country, taking their capital as well as their skills with them.

In fact, what is now known as "portfolio" investment – the purchase by the nationals of one country of the stocks or bonds of the companies of another – has usually been less important quantitatively than this "direct" investment. In 1967 U. S. private investments abroad were estimated to total $93 billion, of which $12 billion were short-term assets and claims, and $81 billion long-term. Of American long-term private investments abroad, $22 billion were portfolio investments and $59 billion direct investments.

The export of private capital for private investment has on the whole been extremely profitable for the capital-exporting countries. In every one of the twenty years from 1945 to 1964 inclusive, for example, the income from old direct foreign investments by U. S. companies exceeded the outflow of new direct investments. In that twenty-year period new outflows of direct investments totaled $22.8 billion, but income from old direct investments came to $37.1 billion, plus $4.6 billion from royalties and fees, leaving an excess inflow of $18.9 billion. In fact, with the exception of 1928, 1929, and 1931, U. S. income from direct foreign investments exceeded new capital

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outlays in every year since 1919.[1]

Our direct foreign investments also greatly stimulated our merchandise exports. The U. S. Department of Commerce found that in 1964, for example, $6.3 billion, or 25 per cent of our total exports in that year, went to affiliates of American companies overseas.

It is one of the ironies of our time, however, that the U. S. government decided to put the entire blame for the recent "balance-of-payments deficit" on American investments abroad; and beginning in mid-1963, started to penalize and restrict such investment.

The advantages of international investment to the capital importing country should be even more obvious. In any backward country there are almost unlimited potential ventures, or "investment opportunities," that are not undertaken chiefly because the capital to start them does not exist. It is the domestic lack of capital that makes it so difficult for the "underdeveloped" country to climb out of its wretched condition. Outside capital can enormously accelerate its rate of improvement.

Investment from abroad, like domestic investment, can be of two kinds: the first is in the form of fixed interest-bearing loans, the second in the form of direct equity investment in which the foreign investor takes both the risks and the profits. The politicians of the capital-importing country usually prefer the first. They see their nationals, say, making 15 or 30 per cent annual gross profit on a venture, paying off the foreign lender at a rate of only 6 per cent, and keeping the difference as net profit. If the foreign investor makes a similar assessment of the situation, however, he naturally prefers to make the direct equity investment himself.

But the foreigner's preference in this regard does not necessarily mean that the capital-importing country is injured. It is to its own advantage if its government puts no vexatious restrictions on the form or conditions of the private foreign investment. For if the foreign investor imports, in addition to his capital, his own (usually) superior management, experience, and technical know-how, his enterprise may be more likely to succeed. He cannot help but give employment to labor in the capital-importing country, even if he is allowed to bring in labor freely from his own. Self-interest and wage-rate differentials will probably soon lead him to displace most of whatever common or even skilled labor he originally brings

[1] See *The United States Balance of Payments* (Washington: International Economic Policy Association, 1966), pp. 21 and 22.

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in from his own country with the labor of the host country. He will usually supply the capital-importing country itself with some article or amenity it did not have before. He will raise the average marginal productivity of labor in the country in which he has built his plant or made his investment, and his enterprise will tend to raise wages there. And if his investment proves particularly profitable, he will probably keep reinvesting most of his profits in it as long as the market seems to justify the reinvestment.

There is still another benefit to the capital-importing country from private foreign investment. The foreign investors will naturally seek out first the most profiitable investment opportunities. If they choose wisely, these will also be the investments that produce the greatest surplus of market value over costs and are therefore economically most productive. When the originally most productive investment opportunities have been exploited to a point where the comparative rate of return begins to diminish, the foreign investors will look for the next most productive investment opportunities, originally passed over. And so on. Private foreign investment will therefore tend to promote the most rapid rate of economic improvements.

Foreigners Are Suspect

It is unfortunate, however, that just as the government of the private-capital-exporting country today tends to regard its capital exports with alarm as a threat to its "balance of payments," the government of the private-capital-importing country today tends to regard its capital imports at least with suspicion if not with even greater alarm. Doesn't the private-capital-exporting country make a profit on this capital? And if so, mustn't this profit necessarily be at the expense of the capital-importing country? Mustn't the latter country somehow be giving away its patrimony? It seems impossible for the anticapitalist mentality (which prevails among the politicians of the world, particularly in the underdeveloped countries) to recognize that both sides normally benefit from any voluntary economic transaction, whether a purchase-sale or a loan-investment, domestic or international.

Chief among the many fears of the politicians of the capital-importing country is that foreign investors "take the money out of the country." To the extent that this is true, it is true also of domestic investment. If a home owner in Philadelphia gets a mortgage from an investor in New York, he may point out that his interest and amortization pay-

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ments are going out of Philadelphia and even out of Pennsylvania. But he can do this with a straight face only by forgetting that he originally borrowed the money from the New York lender either because he could not raise it at all in his home city or because he got better terms than he could get in his home city. If the New Yorker makes an equity investment in Pennsylvania, he may take out all the net profits; but he probably employs Pennsylvania labor to build his factory and operate it. And he probably pays out $85 to $90 annually for labor, supplies, rent, etc., mainly in Pennsylvania, for every $10 he takes back to New York. (In 1969, American manufacturing corporations showed a net profit after taxes of only 5.4 per cent on total value of sales.) "They take the money out of the country" is an objection against foreign investors resulting even more from xenophobia than from anticapitalism.

Fear of Foreign Control

Another objection to foreign investment by politicians of the capital-importing country is that the foreign investors may "dominate" the borrowing country's economy. The implication (made in 1965 by the de Gaulle government of France, for example) is that American-owned companies might come to have too much to say about the economic decisions of the government of the countries in which they are located. The real danger, however, is the other way round. The foreign-owned company puts itself at the mercy of the government of the host country. Its capital in the form of buildings, equipment, drilled wells and refineries, developed mines, and even bank deposits, may be trapped. In the last twenty-five years, particularly in Latin America and the Middle East, as American oil companies and others have found to their sorrow, the dangers of discriminatory labor legislation, onerous taxation, harassment, or even expropriation, are very real.

Yet the anticapitalistic, xenophobic, and other prejudices against private foreign investment have been so widespread, in both the countries that would gain from importing capital and the countries that would profit from exporting it, that the governments in both sets of countries have imposed taxes, laws and regulations, red tape, and other obstacles to discourage it.

At the same time, paradoxically, there has grown up in the last quarter-century powerful political pressures in both sets of countries in favor of the richer countries *giving capital away* to the poorer

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in the form of government-to-government "aid."

The Marshall Plan

This present curious giveaway mania (it can only be called that on the part of the countries making the grants) got started as the result of an historical accident. During World War II, the United States had been pouring supplies – munitions, industrial equipment, foodstuffs – into the countries of its allies and cobelligerents. These were all nominally "loans." American Lend-Lease to Great Britain, for example, came to some $30 billion and to Soviet Russia to $11 billion.

But when the war ended, Americans were informed not only that the Lend-Lease recipients could not repay and had no intention of repaying, but that the countries receiving these loans in wartime had become dependent upon them and were still in desperate straits, and that further credits were necessary to stave off disaster.

This was the origin of the Marshall Plan.

On June 5, 1947, General George C. Marshall, then American Secretary of State, made at Harvard the world's most expensive commencement address, in which he said:

"The truth of the matter is that Europe's requirements, for the next three or four years, of foreign food and other essential products – principally from America – are so much greater than her present ability to pay that she must have substantial additional help, or face economic, social, and political deterioration of a very grave character."

Whereupon Congress authorized the spending in the following three-and-a-half years of some $12 billion in aid.

This aid was widely credited with restoring economic health to "free" Europe and halting the march of communism in the recipient countries. It is true that Europe did finally recover from the ravages of World War II – as it had recovered from the ravages of World War I. And it is true that, apart from Yugoslavia, the countries not occupied by Soviet Russia did not go communist. But whether the Marshall Plan accelerated or retarded this recovery, or substantially affected the extent of communist penetration in Europe, can never be proved. What can be said is that the plight of Europe in 1947 was at least as much the result of misguided European governmental economic policies as of physical devastation caused by the war. Europe's recovery was far slower than it could have been, with or without the Marshall Plan.

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This was dramatically demonstrated in West Germany in 1948, when the actions between June 20 and July 8 of Economic Minister Ludwig Erhard in simultaneously halting inflation, introducing a thoroughgoing currency reform, and removing the strangling network of price controls, brought the German "miracle" of recovery.

As Dr. Erhard himself described his action: "We decided upon and re-introduced the old rules of a free economy, the rules of *laissez-faire*. We abolished practically all controls over allocation, prices, and wages, and replaced them with a price mechanism controlled predominantly by money."

The result was that German industrial production in the second half of 1948 rose from 45 per cent to nearly 75 per cent of the 1936 level, while steel production doubled that year.

It is sometimes claimed that it was Germany's share of Marshall aid that brought on the recovery. But nothing similar occurred in Great Britain, for example, which received more than twice as much Marshall aid. The German per capita gross national product, measured in constant prices, increased 64 per cent between 1950 and 1958, whereas the per capita increase in Great Britain, similarly measured, rose only 15 per cent.

Once American politicians got the idea that the American taxpayer owed other countries a living, it followed logically that his duty could not be limited to just a few. Surely that duty was to see that poverty was abolished everywhere in the world. And so in his inaugural address of January 20, 1949, President Truman called for "a bold new program" to make "the benefits of our scientific advances and industrial progress available for the improvement and growth of underdeveloped areas.... This program can greatly increase the industrial activity in other nations and can raise substantially their standards of living."

Because it was so labeled in the Truman address, this program became known as "Point Four." Under it the "emergency" foreign aid of the Marshall Plan, which was originally to run for three of four years at most, was universalized, and has now been running for more than twenty years. So far as its advocates and built-in bureaucracy are concerned, it is to last until foreign poverty has been abolished from the face of the earth, or until the per capita "gap" between incomes in the backward countries and the advanced countries has been closed – even if that takes forever.

The cost of the program already is appalling. Total disbursements to foreign nations, in the fiscal

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years 1946 through 1970, came to $131 billion. The total net interest paid on what the U. S. borrowed to give away these funds amounted in the same period to $68 billion, bringing the grand total through the 25-year period to $199 billion.[2]

This money went altogether to some 130 nations. Even in the fiscal year 1970, the aid program was still operating in 99 nations and five territories of the world, with 51,000 persons on the payroll, including U. S. and foreign personnel. Congressman Otto E. Passman, chairman of the Foreign Operations Subcommittee on Appropriations, declared on July 1, 1969: "Of the three-and-a-half billion people of the world, all but 36 million have received aid from the U. S."

Domestic Repercussions

Even the colossal totals just cited do not measure the total loss that the foreign giveaway program has imposed on the American economy. Foreign aid has had the most serious economic side-effects. It has led to grave distortions in our economy. It has undermined our currency, and contributed toward driving us off the gold standard. It has accelerated our inflation. It was sufficient in itself to account for the total of our Federal deficits in the 1946-70 period. The $199 billion foreign aid total exceeds by $116 billion even the $83 billion increase in our gross national debt during the same years. Foreign aid has also been sufficient in itself to account for all our balance-of-payments deficits (which our government's policies blame on private foreign investment).

The advocates of foreign aid may choose to argue that though our chronic Federal budget deficits in the last 25 years *could* be imputed to foreign aid, we could alternatively impute those deficits to other expenditures, and assume that the foreign aid was paid for entirely by raising additional taxes. But such an assumption would hardly improve the case for foreign aid. It would mean that taxes during this quarter-century averaged at least $5 billion higher each year than they would have otherwise. It would be difficult to exaggerate the setbacks to personal working incentives, to new ventures, to profits, to capital investment, to employment, to wages, to living standards, that an annual burden of $5 billion in additional taxation can cause.

If, finally, we make the "neutral" assumption that our $131 or $199 billion in foreign aid (whichever way we choose to calculate the

[2] Source: Foreign Operations Subcommittee on Appropriations, House of Representatives, July 1, 1970.

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sum) was financed in exact proportion to our actual deficit and tax totals in the 25-year period, we merely make it responsible for part of both sets of evils.

In sum, the foreign aid program has immensely set back our own potential capital development. It ought to be obvious that a foreign giveaway program can raise the standards of living of the so-called "underdeveloped areas" of the world only by lowering our own living standards compared with what they could otherwise be. If our taxpayers are forced to contribute millions of dollars for hydroelectric plants in Africa or Asia, they obviously have that much less for productive investment in the U. S. If they contribute $10 million dollars for a housing project in Uruguay, they have just that much less for their own housing, or any other cost equivalent, at home. Even our own socialist and statist do-gooders would be shaken if it occurred to them to consider how much might have been done with that $131 or $199 billion of foreign aid to mitigate pollution at home, build subsidized housing, and relieve "the plight of our cities." Free enterprisers, of course, will lament the foreign giveaway on the far more realistic calculation of how enormously the production, and the wealth and welfare of every class of our population, could have been increased by $131 to $199 billion in more private investment in new and better tools and cost-reducing equipment, and in higher living standards, and in more and better homes, hospitals, schools, and universities.

The Political Arguments

What have been the economic or political compensations to the United States for the staggering cost of its foreign aid program? Most of them have been illusory.

When our successive Presidents and foreign aid officials make inspirational speeches in favor of foreign aid, they dwell chiefly on its alleged humanitarian virtues, on the need for American generosity and compassion, on our duty to relieve the suffering and share the burdens of all mankind. But when they are trying to get the necessary appropriations out of Congress, they recognize the advisability of additional arguments. So they appeal to the American taxpayer's material self-interest. It will redound to his benefit, they argue, in three ways: 1. It will increase our foreign trade, and consequently the profits from it. 2. It will keep the underdeveloped countries from going communist. 3. It will turn the recipients of our grants into our eternally grateful friends.

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The answers to these arguments are clear:

1. Particular exporters may profit on net balance from the foreign aid program, but they necessarily do so at the expense of the American taxpayer. It makes little difference in the end whether we give other countries the dollars to pay for our goods, or whether we directly give them the goods. We cannot grow rich by giving our goods or our dollars away. We can only grow poorer. (I would be ashamed of stating this truism if our foreign aid advocates did not so systematically ignore it.)

2. There is no convincing evidence that our foreign aid played any role whatever in reversing, halting, or even slowing down any drift toward communism. Our aid to Cuba in the early years of the program, and even our special favoritism toward it in assigning sugar quotas and the like, did not prevent it from going communist in 1958. Our $769 million of aid to the United Arab Republic did not prevent it from coming under Russian domination. Our $460 million aid to Peru did not prevent it from seizing American private properties there. Neither our $7,715 million aid to India, nor our $3,637 million aid to Pakistan, prevented either country from moving deeper and deeper into socialism and despotic economic controls. Our aid, in fact, subsidized these very programs, or made them possible. And so its goes, country after country.

3. Instead of turning the recipients into grateful friends, there is ever-fresh evidence that our foreign aid program has had precisely the opposite effect. It is pre-eminently the American embassies and the official American libraries that are mobbed and stoned, the American flag that is burned, the Yanks that are told to go home. And the head of almost every government that accepts American aid finds it necessary to denounce and insult the United States at regular intervals in order to prove to his own people that he is not subservient and no puppet.

So foreign aid hurts both the economic and political interest of the country that extends it.

The Unseen Costs of Utopian Programs

But all this might be overlooked, in a broad humanitarian view, if foreign aid accomplished its main ostensible purpose of raising the living levels of the countries that received it. Yet both reason and experience make it clear that in the long run it has precisely the opposite effect.

Of course, a country cannot give away $131 billion without its doing *something* abroad (though we

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must always keep in mind the reservation – instead of something *else* at home). If the money is spent on a public housing project, on a hydroelectric dam, on a steel mill (no matter how uneconomic or ill-advised), the housing or the dam or the mill is brought into existence. It is visible and undeniable. But to point to that is to point only to the visible gross gain while ignoring the costs and the offsets. In all sorts of ways – economic, political, spiritual – the aid in the long run hurts the recipient country. It becomes dependent on the aid. It loses self-respect and self-reliance. The poor country becomes a pauperized country, a beggar country.

There is a profound contrast between the effects of foreign aid and of voluntary private investment. Foreign aid goes from government to government. It is therefore almost inevitably statist and socialistic. A good part of it goes into providing more goods for immediate consumption, which may do nothing to increase the country's productive capacity. The rest goes into government projects, government five-year plans, government airlines, government hydroelectric plants and dams, or government steel mills, erected principally for prestige reasons, and for looking impressive in colored photographs, and regardless of whether the projects are economically justified or self-supporting. As a result, real economic improvement is retarded.

The Insoluble Dilemma

From the very beginning, foreign aid has faced an insoluble dilemma. I called attention to this in a book published in 1947, *Will Dollars Save the World?*, when the Marshall Plan was proposed but not yet enacted:

"Intergovernmental loans [they have since become mainly gifts, which only intensifies the problem] are on the horns of this dilemma. If on the one hand they are made without conditions, the funds are squandered and dissipated and fail to accomplish their purpose. They may even be used for the precise opposite of the purpose that the lender had in mind. But if the lending government attempts to impose conditions, its attempt causes immediate resentment. It is called 'dollar diplomacy'; or 'American imperialism'; or 'interfering in the internal affairs' of the borrowing nation. The resentment is quickly exploited by the Communists in that nation."

In the 23 years since the foreign-aid program was launched, the administrators have not only failed to find their way out of this dilemma; they have refused even to acknowledge its existence. They

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have zigzagged from one course to the other, and ended by following the worst course of all: they have insisted that the recipient governments adopt "growth policies" – which mean, in practice, government "planning," controls, inflation, ambitious nationalized projects – in brief, socialism.

If the foreign aid were not offered in the first place, the recipient government would find it advisable to try to attract foreign private investment. To do this it would have to abandon its socialistic and inflationary policies, its exchange controls, its laws against taking money out of the country. It would have to abandon harassment of private business, restrictive labor laws, and discriminatory taxation. It would have to give assurances against nationalization, expropriation, and seizure.

Specifically, if the nationals of a poor country wanted to borrow foreign capital for a private project, and had to pay a going rate of, say, 7 per cent interest for the loan, their project would have to be one that promised to yield at least 7 per cent before the foreign investors would be interested. If the government of the poor country, on the other hand, can get the money from a foreign government without having to pay interest at all, it need not trouble to ask itself whether the proposed project is likely to prove economic and self-liquidating or not. The essential market guide to comparative need and utility is then completely removed. What decides priorities is the grandiose dreams of the government planners, unembarrassed by bothersome calculations of comparative costs and usefulness.

The Conditions for Progress

Where foreign government aid is not freely offered, however, a poor country, to attract private foreign investment, must establish an actual record of respecting private property and maintaining free markets. Such a free-enterprise policy by itself, even if it did not at first attract a single dollar of foreign investment, would give enormous stimulus to the economy of the country that adopted it. It would first of all stop the flight of capital on the part of its own nationals and stimulate *domestic* investment. It is constantly forgotten that both domestic and foreign capital investment are encouraged (or discouraged) by the same means.

It is not true, to repeat, that the poor countries are necessarily caught in a "vicious circle of poverty," from which they cannot escape without massive handouts from abroad. It is not true that "the rich countries are getting richer while the poor countries are

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getting poorer." It is not true that the "gap" between the living standards of the poor countries and the rich countries is growing ever wider. Certainly that is not true in any *proportionate* sense. From 1945 to 1955, for example, the average rate of growth of Latin American countries in national income was 4.5 per cent per annum, and in output per head 2.4 per cent – both rates appreciably higher than the corresponding figure for the United States.[3]

Intervention Breeds Waste

The foreign aid ideology is merely the relief ideology, the guaranteed-income ideology, applied on an international scale. Its remedy, like the domestic relief remedy, is to "abolish poverty" by seizing from the rich to give to the poor. Both proposals systematically ignore the reasons for the poverty they seek to cure. Neither draws any distinction between the poverty caused by misfortune and the poverty brought on by shiftlessness and folly. The advocates of both proposals forget that their chief attention should be directed to restoring the incentives, self-reliance, and *production* of the poor family or the poor country, and that the principal means of doing this is through the free market.

In sum, government-to-government foreign aid promotes statism, centralized planning, socialism, dependence, pauperization, inefficiency, and waste. It prolongs the poverty it is designed to cure. Voluntary private investment in private enterprise, on the other hand, promotes capitalism, production, independence, and self-reliance. It is by attracting foreign private investment that the great industrial nations of the world were once helped. It is so that America itself was helped by British capital, in the nineteenth century, in building its railroads and exploiting its great national resources. It is so that the still "underdeveloped areas" of the world can most effectively be helped today to develop their own great potentialities and to raise the living standards of their masses.

[3] Cf. "Some Observations on 'Gapology,'" by P. T. Bauer and John B. Wood in *Economic Age* (London), November-December 1969. Professor Bauer is one of the few academic economists who have seriously analyzed the fallacies of foreign aid. See also his Yale lecture on foreign aid published by The Institute of Economic Affairs (London), 1966, and his article on "Development Economics" in *Roads to Freedom: Essays in Honour of Friedrich A. von Hayek* (London: Routledge & Kegan Paul, 1969). I may also refer the reader to my own book, *Will Dollars Save the World?* (Appleton, 1947), to my pamphlet, *Illusions of Point Four* (Irvington-on-Hudson, New York: Foundation for Economic Education, 1950), and to my chapter on "The Fallacy of Foreign Aid" in my *Man Vs. the Welfare State* (Arlington House, 1969).

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A Youthful Purpose

JAMES W. MULLER

This article is from the address presented by Mr. Muller as valedictorian of the 1970 graduating class of the Horace Greeley High School in Chappaqua, New York.

* * *

TURN to the person sitting next to you. Now ask yourself if you could be this person for just one day. Could you go through his life acting just as he would?

The answer, obviously, is no. This person is an individual. You are another. Your lives are not interchangeable.

And would you let him be you for a day? Certainly not! There would be no telling what he might do to your friendships, what silly propositions he might accept in your name, or which of your possessions he might lose or waste.

If the question were rephrased so that you became him for his whole life, the answer would be no, even more resolutely.

And if the question dealt with the population of a whole nation, it would be absolutely preposterous! Each of us expends all his waking energies running his own life; it would be inconceivable for anyone to run more than one.

But a whole conception of government is based on this absurdity, and it is the system which has always ruled the majority of mankind. Not at all surprisingly, it has done very poorly. Statism has slipped through history as feudalism, absolute monarchy, proletarian dictatorship, fascism, socialism, and in a score of other guises. Every form is based on the thesis that someone should be able to force you to do something you would rather not do. The instrument is coercion. By wielding this club the state rules men.

Having discovered the nature of statism, we ought to look critically at our own society to see if we are guided by its tenets. But first it is necessary to decide what the state should properly do.

It is evident that men, if left to do literally whatever they wanted to, would soon begin to take unfair advantage of other men by

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subverting their liberties through brute force. This, unfortunately, is the history of human behavior. Thus we set up an agency to defend our liberties from internal or external attack. This agency has come to be called government. Experience has shown that certain systems of organization for its operation work best, and the men who wrote our Constitution did a remarkable job of establishing a workable system. Essentially, then, the purpose of the state is to ensure the liberties of all the people by using negative restraints. It is not to enter the social, economic, or moral realms in the hope of remaking men in a better image. To do so is only to subvert the very liberties it is designed to safeguard.

The State Out of Bounds — and Few Seem to Care

In our society we have such an agency whose organizational units are dispersed throughout the nation. With only a cursory examination, however, we see that it has gone far beyond its proper bounds. Furthermore, few people oppose this false direction for the state.

Instead, the current debate centers rather ludicrously on trying to determine what form of statism is most enlightened. We hear of a critical discussion waging in Washington on what are called national priorities. This term is conveniently misleading because it implies that one or another improper governmental function is most important — more important than our own activities. It fails to recognize that our national priorities were set almost two hundred years ago. Most important to each of us are his individual priorities, and to set these is not the state's responsibility.

The disputants in this great debate over priorities attempt to decide which coercive functions of the state are most crucial. Perhaps a farmer argues with a senior citizen about the relative virtues of parity payments and social security. Here we see the statist mentality at work. Frédéric Bastiat, a French economist, exposed the futility of this conception in his perceptive aphorism: "The state is the great fiction by which everyone tries to live at the expense of everyone else." Never is there a brief recess to reflect that just possibly a man can ethically tap only his own resources. A thin veil called democracy cannot conceal plunder. Coercion by a majority is no less reprehensible than that perpetrated by a tyrant, even if its application is less bold and bloody and bright.

There is a strong reluctance on the part of the American people to

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part with the cherished sanctuaries of statism in their midst. I was once discussing an especially blatant example of statism in this country when one of the group exclaimed: "Why, I think your ideas are frightening!" Somewhat taken aback at first, I replied: "You find it frightening that I don't want to run your life and don't want you to run mine?" This was a new thought.

The statist feature in question was public education, a system characterized by state-run schools which have a high degree of compulsion in curriculum, attendance, and other features. Not only must every child attend these schools, or others approved by the state, but every person of suitable income must pay for their operation and maintenance. And the great potential for widespread and meaningful progress through free education has declined.

Recently I expressed pleasure that the bond issue for the construction of a new library in Chappaqua had failed. Another person immediately said he agreed with me that the site in question was not a good one. He was then rather astonished when I replied: "On the contrary, it was a good site. I hope someone builds a library there. But not the town of Chappaqua."

And the reaction to my offhand remark that democracy alone would never guarantee liberty was even more revealing. "What," asked my companion, "you are against majority control?" I replied that I was against control if it meant coercion, adding: "Democracy is an equitable way to choose our public officials, but with it must go a better understanding of the proper role of the state."

Until we recognize that fact – that just as the factory guard was never intended to be the plant manager, the government's purpose is not to rule but to keep the peace – we in America will be forever susceptible to what Jefferson called "every form of tyranny over the mind of man." Restraints on creative energy do no good. Coercion in a humanitarian guise – and here I mean social security, minimum wage laws, welfare payments, and the like – does no good. Legislated morality – and here I mean antipornography laws, prohibition, laws against cigarette advertising, and the like – does no good. And governmental monopolies, outright or clandestine, on any enterprise – and here I mean regulating such businesses as the telecommunications industry to such an extent that their every move must be sanctioned by the government, building roads, running our star-crossed state mail system, and the like – do no good.

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Closed to Further Thought

I am told that if the government did not accomplish all these functions, no one would. But consider the train of thought involved. Once the government becomes involved in any enterprise, it is thought that no one else could accomplish it, simply because no one else is allowed to try. Whether the prohibition is effected by outright legislation or through economic pressure, it is impossible for anyone to conceive of another course. (If you tried to set up a rival post office system now, you would soon run into all the problems I am discussing.) Now imagine for a moment that the government at its inception had decided, for whatever reason, that it would provide shoes and socks to every American child until the age of twelve. If someone later proposed that this be handled by the free market, the retort would be that clearly only the government could handle this function. Surely those who wish to end the state's role would have the children walk around without shoes and socks and freeze in the winter, would have them get nails and thorns in their tender feet as they walk to school unshod! What inhumanity indeed!

A favorite tack of statists is to respond to attacks on the statist machinery by asking: "What would you put in place of those things you wish were abolished?" This question is usually followed by general comments about the necessity of being constructive.

To my mind no greater fallacy has worked its way into the American character. It assumes that the person who wishes to stop improper governmental activities is all set to substitute his own blueprint for the society in their place. It ignores the fact that there are two hundred million Americans, each of whom may have ideas to handle these activities, and each of whom will be allowed to implement them in the free market if he so wishes. I certainly do not have all the answers, because I am only one of the two hundred million. Perhaps I would not have thought of the light bulb, but Thomas Edison did, and we are all the better for it. No such invention has been produced through coercive force.

Robert Goddard, the father of modern rocketry, said in his high school valedictory address in 1904: "It is difficult to say what is impossible, for the dream of yesterday is the hope of today and the reality of tomorrow."

It is my hope today that the dream of the men who wrote the Constitution will become the reality of our tomorrow.

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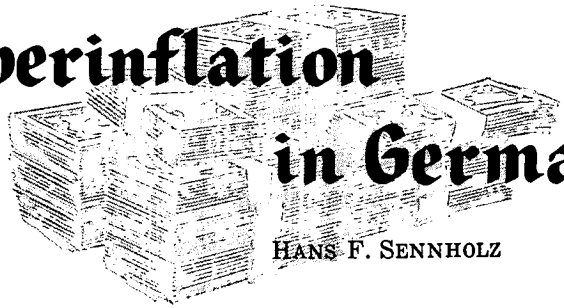
Hyperinflation in Germany



HANS F. SENNHOLZ

THE ORGANIZATION for Economic Cooperation and Development, which endeavors to achieve international coordination of government policies, recently expressed alarm about the ever accelerating rates of inflation. It called the pace of monetary depreciation "unacceptably high" and warned about the inherent dangers of a major business depression as a result of rampant inflation. In fact, many European economists are convinced that "the Western world is at the threshhold of a runaway inflation of the Latin-American type."

During the 1950's we had grown accustomed to a creeping depreciation of currencies at an average rate of 2 per cent a year. During the 1960's the rate had climbed to 4 and 5 per cent; last year it reached 6 per cent, which is well beyond the creeping pace. And, if we project the depreciation growth rates of the 1960's to the 1970's, we must brace ourselves for inflation of 10 to 20 per cent annually.

We need not here analyze many political and social aspects of this ominous development in the Western world. But we should like to review the history of the greatest inflation of the century, the German hyperinflation of the early 1920's, and the ideological causes that brought it about. For history is the glass through which we may behold the deeds and errors, the foibles and misfortunes of mankind.

The German inflation, too, began with a creeping rate of one and two per cent. When World War I broke out, the central bank (Reichsbank) immediately suspended redeemability of its notes in order to prevent a run on its gold reserves. Then it offered assistance to the central government toward financing the war effort. As taxes are always unpopular the government preferred to borrow huge amounts of money to cover

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its budgetary deficits. And the central bank assisted every issue of new treasury obligations by discounting much of it. Thus, a large percentage of government debt found its way into the vaults of the Reichsbank and an equivalent amount of printing-press money into the peoples' cash holdings. As in other belligerent countries, the central bank was monetizing the growing government debt.

By the end of the war, the amount of money in circulation had risen fourfold and prices some 140 per cent. Yet, the German mark had suffered no more than the British pound, was somewhat weaker than the American dollar, but stronger than the French franc. Five years later, in December 1923, the Reichsbank had issued 496.5 quintillion marks each of which had fallen to one trillionth of its 1914 gold value.[1]

[1] According to the British and German systems of numeration, the billion is a million of millions, a trillion a million of billions, and each higher denomination (e.g. quadrillion, quintillion, sextillion, etc.) is a million times the one preceding. In the American system, the billion is a thousand millions, and each higher denomination is a thousand times the preceding. It must also be noted that a billion in the U.S. system is called milliard in the British and German systems. In German and British texts the sentence would thus read: "Five years later in December 1923 the Reichsbank had issued 496.5 trillion marks each of which had fallen to one billionth of its 1914 gold value."

How stupendous! Practically every item of trade was costing trillions of marks. The American dollar was quoted at 4.2 trillion marks, the American penny at 42 billion marks. How could a European nation that prided itself on its high levels of education and scholarly knowledge suffer such a thorough destruction of its money? Who would inflict on a great nation such evil which had ominous economic, social, and political ramifications not only for Germany but for the whole world? Was it the victors of World War I who, in diabolical revenge, devastated the vanquished country through ruinous financial manipulation and plunder?

Every mark was printed by Germans and issued by a central bank that was governed by Germans under a government that was purely German. It was German political parties, such as the Socialists, the Catholic Centre Party, and the Democrats, forming various coalition governments, that were solely responsible for governmental policies. Of course, admission of responsibility for any calamity cannot be expected from any political party.

The reasoning that led these parties to inflate the national currency at such astronomical rates is not only interesting for economic historians, but also exposes

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the rationale of monetary destruction. The doctrines and theories that led to the German monetary destruction have been applied with similar consequences in many other countries, and underlie the rampant inflation throughout the Western world today.

Four erroneous doctrines or theories guided the German monetary authorities in those baleful years.

No Inflation in Germany

The most amazing economic sophism advanced by eminent financiers, politicians, and economists endeavored to show that there was neither monetary nor credit inflation in Germany. These experts readily admitted that the nominal amount of paper money issued was indeed enormous. But the *real value* of total currency in circulation, that is, the total value in terms of gold or goods prices, they argued, was much lower than before the war and low relative to that of other industrial countries.

The Minister of Finance, celebrated economist Helfferich, repeatedly assured his nation that there was no inflation in Germany since the total value of currency in circulation, when measured in gold, was covered by the gold reserves in the Reichsbank at a much higher ratio than before the war.[2]

The President of the Reichsbank Havenstein categorically denied that the Central Bank had inflated the German currency. He was convinced that it followed a restrictive policy since its portfolio was worth, in gold marks, less than half its 1913 holdings.

Professor Julius Wolf wrote in the summer of 1922: "In proportion to the need, less money circulates in Germany now than before the war. This statement may cause surprise, but it is correct. The circulation is now 15 to 20 times that of pre-war days, whilst prices have risen 40 to 50 times." Similarly, Professor Elster reassured his people: "However enormous may be the apparent rise in the circulation in 1922, actually the figures show a decline."[3]

The Statistical Bureau of the German Government even calculated the real values of the per capita circulation in various countries. It, too, concluded that there was a shortage of currency in Germany, but a great deal of inflation abroad.

Of course, this fantastic conclusion drawn by monetary authorities and experts bore ominous consequences for millions of people. Through devious sophisms, it simply denied individual responsibility for the disaster and thus

[2] *Das Geld*, 1923, p. 646.

[3] *Von der Mark zur Reichsmark*, 1928, p. 167.

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removed all limits to the issuance of more paper money.

GOLD VALUE OF MONIES IN CIRCULATION

	Gold Marks Per Person	
	1920	*1922*
Germany	87.63	17.92
England	84.40	110.73
France	180.05	229.90
Switzerland	89.49	103.33
U.S.A.	101.35	97.66

SOURCE: *Wirtschaft und Statistik*, 1923, No. 1. (To arrive at U.S. dollar amounts these figures should be divided by 4.2.)

The source of this momentous error probably lies in failure to understand one of the most important determinants of money value: the attitude of people toward money. For one reason or another, people may vary their cash holdings. An increase in cash holdings by many people tends to raise the exchange value of money; reduction in cash holdings tends to lower it. Now, in order to radically change their cash holdings, individuals must have cogent reasons. They naturally enlarge their holdings whenever they anticipate rising money value as, for instance, in a depression. And they reduce their holdings whenever they expect declining money value. In the German hyperinflation, they reduced their holdings to an absolute minimum and finally avoided any possession at all. It is obvious that goods prices must then rise faster and the value of money depreciate faster than the rate of money creation. And if the value of individual cash holdings declines faster than the rate of money printing, the value of the total stock of money must also depreciate faster than this rate.

This is so well understood that even the mathematical economists emphasize the money "velocity" in their equations and calculations of money value.[4] But the German monetary authorities were unaware of such basic principles of human action.

For Health, Education, Welfare, and Full Employment

Immediately after the war, the German government, under the leadership of the Socialist party, embarked upon heavy expenditures for health, education, and welfare. This added to the already heavy load on the Treasury for demobilization expenses, the demands by the Armistice, the disorders of the revolution, staggering deficits of the nationalized industries, especially the railroads, postal services, telephone, and telegraph. The resources made available by the creation of new money were apparently unlimited! A number of measures for the nationalization

[4] Cf. my essay on "The Value of Money" in THE FREEMAN, Nov. 1969.

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of certain industries (e.g., coal, electrical, and potash industries) were introduced, but failed to become law. The eight-hour day was enacted, and labor unions were given many legal immunities and privileges. In fact, a system of labor councils was set up which authorized the workers in each enterprise to elect representatives who shared in the management of the company!

While government expenditures rose by leaps and bounds, the revenue suffered a gradual decline; in October 1923, only 0.8 per cent of government expenses were covered by tax revenues. For the period from 1914 to 1923 scarcely 15 per cent of the expenses were covered by means of taxes. In the final phase of the inflation the German government experienced a complete atrophy of the fiscal system.

The depreciation of the currency brought about the destruction of taxable wealth in the form of mortgages and bonds, annuities and pensions, which in turn reduced government revenue. It is true, some speculators reaped spectacular profits from the depreciation, but they easily evaded the tax collector. Moreover, the fiscal policies of the Socialist government were openly hostile toward capital and frequently endeavored to impose confiscatory capital levies upon all wealth. Secretary of the Treasury Erzberger even vowed that "in the future Germany, the rich should be no more." Consequently a massive "flight of capital" from Germany developed as all classes of savers invested their money in foreign bank accounts, currencies, bills, securities, and the like. Much taxable wealth was removed from the grip of tax collectors.

Furthermore, the rapid depreciation of currency greatly reduced all tax liabilities during the time interval between the taxable transaction and the date of tax payment. The taxpayer usually paid a sum the real value of which was greatly reduced by inflation. Nevertheless, government expenditure accelerated, while revenue in terms of real value continued to decline. The growing deficits then were met with even larger quantities of printing press money, which in turn generated ever larger deficits. The German monetary authorities were trapped in a vicious circle from which they had neither the political courage nor the financial know-how to extricate themselves.

The leading monetary authority, Dr. Helfferich, even warned his people against the dire consequences of monetary stabilization. "To follow the good counsel of stopping the printing of notes would mean refusing to economic

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life the circulating medium necessary for transactions, payments of salaries and wages, and so on; it would mean that in a very short time the entire public, and above all the Reich, could no longer pay merchants, employees, or workers. In a few weeks, besides the printing of notes, factories, mines, railways and post office, national and local government, in short, all national and economic life would be stopped."[5]

The Balance of Payments and the Treaty of Versailles

Throughout the period of the inflation the most popular explanation of the monetary depreciation laid the blame on an unfavorable balance of payments, which in turn was blamed on the payment of reparations and other burdens imposed by the Treaty of Versailles. To most German writers and politicians, the government deficits and the paper inflation were not the cause, but the consequences, of the external depreciation of the mark.

The wide popularity of this explanation, which charged the victorious allies with full responsibility for the German disaster, bore ominous implications for the future. Its simplicity appealed to the masses of economically ignorant people whose chauvinism and nationalism always make the idea of foreign intrigue and conspiracy so palatable. The intellectual and political leaders who actively propagated the doctrine were sowing the seeds for the whirlwind they ultimately reaped a decade later.

During those baleful years, Germany procured gratuitously from abroad large quantities of raw materials and foodstuffs. According to various authoritative estimates, foreign individuals and banks bought at least 60 billion paper marks which the Reichsbank had floated abroad at an average price of ¼ gold mark for a paper mark. The depreciation of the mark to one trillionth of its earlier value repudiated these foreign claims to German goods. Thus, foreigners suffered losses of some 15 billion gold marks, or some $3.5 billion U.S. dollars, which was eight times more than Germany had paid in foreign exchange on account of reparations.

Even if it had been true that excessive burdens were thrust on Germany by the Allies, there was no need for any monetary depreciation. The two phenomena are entirely independent. If excessive burdens are thrust upon a government, whether they be foreign or domestic, government must raise taxes, or borrow some funds, or curtail other expenditures. Excessive reparation payments may ne-

[5] *Das Geld*, p. 650.

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cessitate higher taxes on the populace, or large loans that reduce the supply of savings for industry and commerce, or painful cuts in government service and employment. The standard of living of the people thus burdened will probably be depressed – unless the reduction of bureaucracy should release new productive energy. But the value of money is not affected by the reparation burden unless economic productivity is impaired by the fund raising.

Once government has achieved the necessary budgetary surplus, the payment of reparations is a simple matter of exchange. The Treasury buys the necessary gold or foreign exchange from its central bank and delivers it to the recipient government. The loss of gold or foreign exchange then necessitates a corresponding reduction of central bank money, which in turn tends to depress the prices of goods. The lowered prices encourage more exports while they discourage imports, that is, generate what is commonly called a "favorable balance of payments" or new influx of gold and foreign exchange. In short, there can be no shortage of gold or foreign exchange as long as the central bank refrains from inflation and monetary depreciation.

The German monetary authorities flatly denied this economic reasoning. Instead, they preferred to lament the excessive burdens thrust onto Germany and the unfavorable balance of payments generated thereby. In 1923 they added yet another excuse: the French occupation of the Ruhr district. The Central Statistical Office put it this way: "The fundamental cause of the dislocation of the German monetary system is the disequilibrium of the balance of payments. The disturbance of the national finances and the inflation are in their turn the consequences of the depreciation of the currency. The depreciation of the currency upset the Budget balance, and determined with an *inevitable necessity* a divergence between income and expenditure, which provoked the upheaval."[6]

Again I quote Dr. Helfferich: "Inflation and the collapse of the exchange are children of the same parent: the impossibility of paying the tributes imposed on us. The problem of restoring the circulation is not a technical or banking problem; it is, in the last analysis, the problem of the equilibrium between the burden and the capacity of the German economy for supporting this burden."[7]

Even American economists

[6] *Deutschlands Wirtschaftslage*, March 1923, p. 24.

[7] "Die Autonomie der Reichsbank" in *Börsen-Courier* of Apr. 4, 1922.

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echoed the German theory. Professor John H. Williams presented this causal order: "Reparation payments, depreciating exchanges, rising import and export prices, rising domestic prices, consequent budgeting deficits, and at the same time an increased demand for bank credit; and finally increased note-issue."[8] And Professor James W. Angell contended that "the reality of the type of analysis which runs *from* the balance of payments and the exchanges *to* general prices and the increased issue of paper seems to be definitely established."[9]

Speculators Did It

When all other explanations are exhausted, modern government usually falls back on the speculator who is held responsible for all economic and social evils. What the witch was to medieval man, the capitalist is to socialists and communists, the speculator is to most politicians and statesmen: the embodiment of evil. He is said to be imbued with ruthless and fickle selfishness that is capable of wrecking the national economy, governmental plans, and, in the case of the German inflation, the national currency. No matter how blatantly contradictory this explanation may be, it is most popular with government authorities in search of a convenient explanation for the failure of their own policies.

The same German officials who denied the very existence of inflation lamented the depreciation caused by speculators. Or they blamed the Allied reparation burdens and simultaneously denounced speculators for the depreciation. Dr. Havenstein, the President of the Reichsbank, embracing every conceivable theory that might clear his own policies of blame, also pointed at the speculators. Before a parliamentary committee, he testified: "On the 28th of March began the attack on the foreign exchange market. In very numerous classes of the German economy, from that day onward, thought was all for personal interests and not for the needs of the country."

In a chorus, the newspapers repeated the charge: "According to all appearances the fall of the mark did not have its origin in the New York exchange, from which it may be concluded that in Germany there was active speculation directed toward the continual rise of the dollar. . . . We are witnessing a rapid increase in the number of those who speculate on the fall

[8] "German Foreign Trade and the Reparations Payments" (*Quarterly Journal of Economics*, 1922, p. 503).

[9] *The Theory of International Prices*, 1926, p. 195.

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of the mark and who are acquiring vested interests in a continual depreciation. . . . The enormous speculation on the rise of the American dollar is an open secret. People who, having regard to their age, their inexperience, and their lack of responsibility, do not deserve support, have nevertheless secured the help of financiers, who are thinking exclusively of their own immediate interests. . . . Those who have studied seriously the conditions of the money market state that the movement against the German mark remained on the whole independent of foreign markets for more than six months. *It is the German bears, helped by the inaction of the Reichsbank, who have forced the collapse in the exchange.*"

In its broadest sense, speculation is every economic action that makes provision for an uncertain future. The student who studies aeronautical engineering speculates on the future demand for his services. The businessman who enlarges his inventory speculates on a profitable market in the future. The housewife who hoards sugar speculates on the availability of sugar in the future. The buyer or seller of goods or securities hopes to make a profit from future changes in prices. All such actions reflect a natural motivation of free men to improve their material well-being or, at least, to avert losses.

When speculators observe or anticipate more inflation and monetary depreciation, they naturally endeavor to sell the depreciating currency and buy goods or foreign exchange that do not depreciate. They are preserving their working capital. Thus, they are promoting not only their own interests but also those of society which benefits from the preservation of productive capital. The government that is actively destroying the currency is injuring the national interest; successful speculators are safeguarding it. Surely, the speculators who sold German marks and bought U.S. dollars proved to be right in the end.

The Current Dilemma in the Light of the German Experience

The world-wide inflation that is engulfing the free world now springs from similar doctrines and theories. It is true, there is no Treaty of Versailles and no reparation payments that can be blamed for the inflation. But in many countries of Central and Western Europe the responsibility for monetary depreciation is squarely laid on American balance of payments deficits that are flooding those countries with U. S. dollars. While European monetary

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authorities are actively inflating and depreciating their own currencies – although at a slower rate than their American counterparts – they are pointing at the U.S. balance of payments as the ultimate cause of their currency depreciation. As in the German hyperinflation foreign intrigue and artifice are said to be at work again.

And again the speculators are charged for a share of the blame. American investors who buy foreign securities or make direct foreign investments are said to be largely responsible for the outflow of U.S. funds and loss of gold, which is creating an unfavorable balance of payments and weakening the U.S. dollar. Moreover, Americans who prefer foreign products over home-made products, or choose to travel abroad rather than stay at home are decried as selfish and unpatriotic. Numerous regulations imposed by the very monetary authorities who perpetrate the inflation aim to prevent speculation in order to save the dollar.

The specious argument that denies the presence of any inflation in terms of purchasing power or gold value may be expected to emerge in later phases of the inflation when monetary authorities will desperately seek any argument that promises to hold them blameless.

The most popular contemporary doctrine that advocates inflation and credit expansion pleads its case in terms of economic boom and full employment. Our economic order which is laboring under heavy government intervention and restriction is a stop-and-go system with alternating booms and busts. The booms are generated by heavy budgetary deficits and monetization of government debt. The busts inevitably follow the booms as soon as stabilization is attempted or the rate of inflation is temporarily slowed in order to prevent a hyperinflation. Under the sway of the "new economics" of Lord Keynes and his American disciples, our monetary authorities inflate and depreciate to finance the boom, and then "reinflate" when the economy falters, to prevent massive unemployment. Inflation is the modern panacea for political, social, and economic evils most of which were created by the inflation itself. In truth, it is a savory poison that slowly kills not only the patients who take it but also the doctors who prescribe it.

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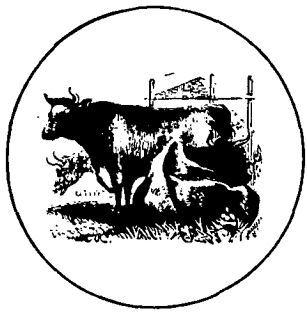
C. R. BATTEN



THE TRAGEDY OF THE COMMONS

THE TITLE for this piece was borrowed from Garrett Hardin and his article that first appeared in *Science,* and later in *The Environmental Handbook* prepared for the First National Environmental Teach-In.

I do not want to imply that I agree with all of Hardin's ideas, but he does give a very good explanation of the tragedy of commonly owned property when each person is free to use it as he sees fit.

He uses as an example the common pasture, where, as explained by Hardin, each herdsman asks, "What is the utility *to me* of adding one more animal to the herd?" This utility has two aspects: the positive one of increased income to the herdsman from the sale of the additional animal, and the negative aspect of increased overgrazing created by one more animal.

Since the positive increment goes entirely to the herdsman, and the negative effect is spread among all the herdsmen who use the pasture, it is obviously to the individual herdsman's advantage to increase the size of his herd, regardless of its effects on the pasture. This same conclusion is reached by every herdsman that shares the common pasture.

As Hardin explains: "Each man is locked into a system that compels him to increase his herd without limit – in a world that is limited. Ruin is the destination toward which all men rush, each pursuing his own best interest in a society that believes in the freedom of the commons. Freedom in a commons brings ruin to all."

With today's increasing concern over our natural resources and our

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environment, ecologists are fond of pointing at present-day deserts in the Middle East, Spain, and other parts of the world that were once productive lands, but were turned by man into nonproductive barrens.

But if we were to study the history of these areas in detail, we would find that they are examples of the "Tragedy of the Commons," where each herdsman tried to reap the most possible benefit to himself from common pastures, without regard to the negative aspects of over-use of the land.

We witnessed the same phenomenon in our own West, when stockmen appropriated vast areas of publicly-owned land for their own use. As long as each stockman had control of "his own range," it was generally well managed, within its grazing capacity. But when the range became overcrowded, and the Federal government yielded to demands to open the public ranges for indiscriminate use, serious overgrazing began, to the detriment not only of the lands, but also of those who used them.

On the other hand, some of the most productive lands of the world have been privately owned and managed for centuries, for the benefit of the owner.

It is not possible to get optimum use out of commonly owned lands, no matter how well regulated they may be by some land agency or authority. Each interest seeks to gain the most possible from the land. The grazier is not interested in the timber resource. The timberman is not interested in the minerals that may lie beneath the soil. The miner is interested in neither the grass nor the trees.

But if the land is owned by an individual, whether he is a rancher, a timberman, or a miner, all the costs and all the benefits accrue to him, so he seeks to make the best possible use of the property. The rational owner realizes that in the long run the practices that are best for the land are the best for him.

The timberman owner sees the grass and makes it available for livestock or wildlife, while making sure that the land will be kept productive for future crops of both timber and grass. Even the miner, who may seemingly destroy the land through strip mining, recognizes that his own best interests require the reclamation of that land for timber, grazing, recreation, or other uses that will satisfy human wants.

So the real "Tragedy of the Commons" is that we have failed to learn from our past experience. We have failed to learn that land and resources in private ownership will not be destroyed, but will be preserved, simply because it is in the owner's best interest to preserve them.

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Profits and Profit-Makers

What does the public think about them?

LAWRENCE FERTIG

IT IS AXIOMATIC that a nation which hopes to substantially improve its standard of living and maximize economic growth must provide maximum freedom for the entrepreneur. For it is the entrepreneur who makes decisions about the use of capital and directs his ideas and energies toward meeting the most urgent demands of the consumer. Upon his efficiency depend the creation of profits and the accumulation of capital so essential to increasing the goods and services available for the citizens of any country.

If the American public clearly understood this concept, the restrictions and impediments placed on the operations of the entrepreneur in the United States would never have been initiated. In this paper I shall try to describe the public image of the entrepreneur, suggest some reasons why the American public has a distorted view of the entrepreneurial function, and discuss some of the effects of this distortion upon the economy of the United States.

According to entrepreneurial theory as developed by Mises and Knight, there would be no profits and no capital accumulation in a static society.[1] A changing society

Mr. Fertig is an economic columnist. This article is condensed from his paper before the meeting of the Mont Pelerin Society in Munich, Germany, September, 1970, being one of several presentations concerning the image of the entrepreneur in various countries.

[1] Frank H. Knight, *Risk, Uncertainty and Profit* (Boston: Houghton Mifflin, 1921), p. 36:

"No *a priori* argument is necessary to prove with general foreknowledge of progressive changes, no losses and no chance to make profits will arise. This is

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is necessary to provide opportunity for the enterpreneur's judgment and talents. Wherever the future is uncertain, the abilities of the entrepreneur come into play. Uncertainty is the basis of the risks he takes. It is his perception, estimates, and judgment about the future which permit him possibly to make a profit and accumulate capital.

According to the above theory, practically everyone is an entrepreneur who employs the factors of production toward fulfilling the needs of the citizens. Some do so efficiently and gain a profit, and some inefficiently and incur a loss. This applies equally to large corporate organizations, small companies, and individuals in their business activity.

Plainly, encouragement of the free market and the absence of strangling restrictions provide the most fertile ground for entrepreneurial skills. This is the basis of a nation's progress. It makes possible increased capital formation, the most efficient use of capital, and the greatest possible increase in the living conditions of all citizens.

Function vs. Image of the Entrepreneur

But unfortunately the *function* of the entrepreneur, as defined by leading neoclassical economists, is hardly the *image* of the entrepreneur in the mind of the man in the street. Perhaps we can clarify this subject by restating the basic question as follows: What do most American citizens think about profits and those who are engaged in making profits? The answer to that question would give us the key to the image of the entrepreneur.

Under our representative form of government, what citizens think about profits and private enterprise has a way of becoming law about this subject.

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the first principle of speculation and is particularly familiar in the capitalization of the anticipated increase in the value of land."

Ludwig von Mises, *Planning for Freedom* (South Holland, Ill.: Libertarian Press, 1952), pp. 119-120:

"Profits are never normal. They vary only where there is a maladjustment, a divergence between actual production and production as it should be in order to utilize the available material and mental resources for the best possible satisfaction of the wishes of the public. They are the price of those who remove this maladjustment that disappear as soon as the maladjustment is entirely removed. In the imaginary construction of an evenly rotating economy there are no profits. There the sum of the prices of the complementary factors of production, due allowance being made for time preference, coincide with the price of the product. . . . It is the entrepreneurial decision that creates either profit or loss. It is mental acts of the mind of the entrepreneur from which profits ultimately originate. Profit is a product of the mind, the success in anticipating the future state of the market."

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There are a number of pieces of evidence which bear on the image of the entrepreneur and can lead us to some valid conclusions. The evidence runs along the following lines:

1. Sporadic opinion polls on profits and the entrepreneur.
2. Laws affecting the entrepreneur which are passed in Congress, including revision of the tax structure.
3. The nature of concepts and ideas which prevail in institutions of higher learning in the U. S. The student of today becomes teacher, editor, community leader, and legislator of tomorrow. What he is taught in college becomes of vital importance to the function of the entrepreneur.
4. Books, articles, and speeches by leading intellectual figures which have a decided effect on the thinking of the typical citizen and on the restraints he is willing to enforce upon enterprise and profit.
5. Entrepreneurial decisions by the man in the street – as opposed to general ideas which he may express – and which can give us a clue as to how he feels about some aspects of profits and free enterprise.

Opinion Polls on the Entrepreneur

Practically all surveys of public opinion reveal that the American public accepts the idea of profits as a necessary part of our business system.[2] But they also reveal that more than half the public is always of the opinion that profits are "too high" and that the public is misinformed on the relative magnitude of wages, profits, and the like. There is a general impression that the workers do not fairly share the wealth which they help to create. For instance, polls show that a great majority of the public believes that the larger share of productivity increases always goes to stockholders in the form of profits. These opinions are especially strong among many professional people – school teachers, ministers, and others.[3] While these surveys do not constitute conclusive evidence, their findings reveal a blurred image of the entrepreneur in the public mind, to say the least.

Favoring the Small Entrepreneur – Penalizing the Big Company

It is important to note one central fact about the image of the entrepreneur which invariably emerges from the evidence at hand. While the typical citizen considers himself to be rather favorable in a general way to

[2] Claude Robinson, *Understanding Profits* (Princeton: D. Van Nostrand & Co.), Ch. 2, "What the Public Thinks of Profits," pp. 30, 31, 32, 33.

[3] *Ibid.*, p. 29.

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private enterprise and profits, he does not think of small companies in the same category as big business. The man in the street knows little or nothing of the function of the entrepreneur as defined by neoclassical economists. He regards the corner grocery store, the hamburger stand, and the recently formed small manufacturer in quite a different light from U.S. Steel, General Motors, DuPont, and the like. Furthermore, he tends to think of an entrepreneur as someone who undertakes a *new* venture, not as an individual or group who must make important judgments every day in the conduct of some vast company like DuPont or General Motors.

Of course, he may be willing to concede that *some phases* of large business activity require entrepreneurial skills, such as promoting new inventions by General Electric, new techniques of producing steel, newly discovered drugs, and so forth. But in the main he conceives of the entrepreneur as a small or medium-size business which is engaged in some new creative effort. This concept of entrepreneurship is reflected in the kind of legislation by Congress which he approves.

Such legislation, for instance, authorized setting up a Small Business Administration (SBA) "to aid the little fellow." The perilous state of small business is often due to the backbreaking load of taxes, work restrictions enforced by labor unions, minimum wage laws which prevent the hiring of needed help, and so forth. Having burdened small business with these restrictions, the government then pursues the usual course of creating new interventions in an attempt to redress the evils which it created by former intervention.

We must contrast this government solicitude for the small and medium-size business with the numerous attacks and harassments on big corporations.

Taxes and the Entrepreneur

We gain further insight into the typical citizen's view of the entrepreneur by analyzing tax legislation which he and his representatives in Congress favor. These tax schedules generally tend to restrict entrepreneurial effort and capital accumulation. This is indeed a curious fact at the present time because there is urgent necessity for greater entrepreneurial effort and more capital in order to meet the needs of industry, states, and municipalities. Whether the problem is antipollution, housing, educational facilities, or transportation, the need is for capital and more capital.

In the face of this need it is

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strange indeed that a responsible legislature would pass the Tax Reform Act of 1969. The complexity of this bill is in itself detrimental to the conduct of business. But most important of all, its main provisions plainly restrict capital accumulation and enterprise. In substance the Act provides for long-run reductions of over $9 billion a year for individuals (mostly lower and middle income), two-thirds of which will be financed by increase on business and capital accumulation. Provisions of the Act which restrict capital accumulation include less depreciation on most new buildings, heavier taxes on producers of natural resources, and smaller loss reserves for financial institutions.

The Act raises the amount of personal income exempt from taxation, thus in effect lowering the tax rates for the low and middle income groups. On the other hand, it increases the tax rate for individuals with annual incomes of $100,000 or more. At the same time the Act repeals the tax credit for investment by corporations which had acted as an incentive for modernizing and expanding production facilities.

One other provision of the new tax law affecting entrepreneurship requires mention. On the personal income tax form there is a provision for "earned income" in one column, and "other income" in another column. The maximum tax on "earned" income will be only 50 per cent, for "other" income 70 per cent. This is one short step from adopting the idea of earned and unearned income — which is obviously a Marxian inheritance. Aside from this basic theoretical implication, the provision on the tax form which separates earned income from that derived from interest, dividends, royalties, and the like, is a clear indication of the tendency to underrate entrepreneurial freedom and the necessity of capital accumulation.

The above provisions (and many more) are undoubtedly a reflection of the attitude of Congress and the people that capital accumulation is not all-important and that large-scale entrepreneurs must be assessed at a higher rate than others.

The Intellectuals' Attack on Large-Scale Entrepreneurs

The public confusion about the nature of the entrepreneur is encouraged by socialistically oriented intellectuals. The general direction of their attack is to castigate the large corporations, to undermine confidence in established companies, and in fact to question the very basis of the free enterprise system. The free market, encour-

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agement of the entrepreneur, and the importance of profits in private enterprise, are generally derided. Ideas advanced by these writers and teachers are the basis for editorials, special articles in magazines, and political campaigns. They become part of the intellectual framework of college students and most of those engaged in formulating social, political, and economic ideas.

Clear evidence of this may be seen in the predominance of textbooks which are anticapitalist at worst, and equalitarian and interventionist at best. A generation of college students have been brought up on the following texts: *Economic Analysis and Public Policy* by Bowman and Bach; *The Elements of Economics* by Lorie Tarshis; *Income and Employment* by Theodore Morgan, and most important of all, *Economics: An Introductory Analysis* by Paul Samuelson. The last-mentioned text has sold several million copies. It is no exaggeration to say that the vast majority of students who assimilated the ideas in these texts completed their education with a very low tolerance for free-market economics and freedom for the entrepreneur. A great number of students were influenced to become absolutely hostile to the free-enterprise system. Undoubtedly a whole generation of opinion-makers were conditioned by these texts.

A nation like the United States which has been nurtured over the years on attacks against the entrepreneur, varying from the scholarly works of Thorstein Veblen to popular books and articles typified by such works as *The Robber Barons* by Matthew Josephson, *The Rich and the Super-Rich* and *The Sixty Families* by Ferdinand Lundberg – such a nation is naturally influenced against the entrepreneur.

Within the past few years there has appeared a book unsympathetic and even hostile to the market economy which has had an important influence on teachers, editors, and other molders of public opinion. This is John Galbraith's *The Industrial State.* Here he strikes directly at big business and the idea of consumer sovereignty.

Schumpeter's Contribution

No discussion of the Intellectual and the Entrepreneur can be considered complete without referring to the brilliant analysis of Joseph A. Schumpeter in his book *Capitalism, Socialism and Democracy,* published nearly a generation ago. The influence of the intellectual who, Schumpeter says, "wields the power of the spoken and written word," is central to his thesis. We

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now clearly see the truth of his statement that "the role of the intellectual group consists primarily in stimulating, energizing, verbalizing and organizing this [anticapitalist] material." Furthermore, "they staff political bureaus, write party pamphlets and speeches, act as secretaries and advisers, make the individual politician's newspaper reputation," and so forth. The point is, according to Schumpeter, that "unlike any other type of society, capitalism inevitably and by virtue of the very logic of its civilization, creates, educates, and subsidizes a vested interest in social unrest. This social unrest is stirred by the sociology of the intellectuals."

It must be noted that not all textbooks and all teaching in American colleges is interventionist or collectivist. In recent years, it is heartening to note, many free-market advocates have established small enclaves in various institutions of learning, and in some cases have written textbooks for college courses. While these ideas are undoubtedly becoming more widespread, there is little doubt that the preponderance of teaching and writing by intellectuals of the United States leans heavily toward intervention and restrictions of the entrepreneur.

It is interesting and perhaps hopeful to note that interventionists and left-wing intellectuals do not have, and never have had, mass support in the United States for a broad-scale political attack upon free enterprise. The intellectual left can nibble away at the profit system, but it does not seem able to form a political base for a frontal attack. Furthermore, the incentive system is so powerful that it has been able to absorb the harassments and attacks made upon it while still maintaining its strength to build a large capital base and to provide the most productive industrial society in the world.

The Man in the Street as Entrepreneur

It must not be assumed that the average citizen is antagonistic to all entrepreneurial effort and free enterprise. In fact, in a general way he approves it, and by his actions indicates that he would like to become an important entrepreneur himself. Evidence of this is at hand in the *investment activities* of the typical citizen — how he handles the cash savings which he has accumulated.

Today there are at least 25 million individual owners of equities in the United States. This is approximately 12 per cent of the entire population and about 25 per cent of the adult population. But to this substantial number must

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be added the millions who invest through mutual funds. The volume of mutual fund investment has grown to over $48 billion – having recorded an accumulation of more than $7 billion in the year 1969. Of course there are duplications among individual investors and mutual fund investors, but taken all in all, the growth of investment by the typical citizen has been phenomenal in the past five or ten years.

Inflation — and the Image of the Entrepreneur

Although the man in the street would assert that he is quite favorable to the general idea of free enterprise and encouragement to profit making, his tolerance for adverse economic conditions is quite low. Whenever conditions become difficult and he feels frustrated with shrinking income and rising costs, his tendency is to opt for government intervention in the economic process. This invariably occurs during a period of substantial monetary inflation, such as we have had in the past few years. Economists, of course, are familiar with the time lag that takes place between changes in monetary policy and changes in the rate of inflationary price increases. But the average citizen does not understand this, and he becomes restless under the pounding he takes during an inflation. Then he demands government intervention at any cost. Under such conditions successful operations of the entrepreneur are impeded.

But it must not be imagined that only consumers run to Washington during periods of inflation. Heads of leading corporations also engage in an unseemly rush to Washington to apply pressure for price and wage controls. Inflation is dangerous for many reasons, especially because it tends to create pressure for government intervention and wage-price control. To encourage a favorable climate for the entrepreneurial effort it is essential to control inflation.

Labor Unions and the Entrepreneur

A discussion of the entrepreneur in the United States should not be concluded without some mention of the effects of labor unions on entrepreneurial activities. Beyond question the rigidity of unions' rules and practices, the restrictions upon entrepreneurial decisions, are an important deterrent. Human nature being what it is, some people are able to operate efficiently despite all the obstructions in their way. It certainly cannot be asserted that unionization and monopoly practices by unions have operated to prevent capital accumulation in the United

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States. The record since 1936, when powerful unions were given monopoly privileges under the law, tends to confirm the fact that entrepreneurs have been able to demonstrate their dynamism and to create a fabulously productive society despite all obstacles.

But conversely, there is little question that the present laws and the practices of unions are a decided drag on entrepreneurial activity.

Also it should be pointed out that powerful unions have the ability to demand and get uneconomic wage increases which act as a force for encouraging monetary inflation by the administration in power.

If labor demands and gets increases of, say, 8 to 10 per cent per annum, and if the Administration holds to a policy of a very limited increase in the money supply, the result would be increased unemployment unless wage increases are offset by productivity increases, which is highly improbable.

Thus, the effect of labor union power is to create a condition which could lead – and generally does – to a new cycle of inflation. Since Washington is sensitive to fears of recession, the tendency is to validate excessive wage increases by excessively increasing the money supply. The old inflation is barely curbed before a new one starts. So the nation goes from one inflationary plateau to another, due to the inexorable pressure of monopoly labor unions.

Conclusion

The image of the entrepreneur in the mind of the American public corresponds only vaguely to the function of the entrepreneur as defined by economists. The public believes that the entrepreneur is an innovator or promoter of something new, and generally is a small business. The fact is that big business and small, innovators and traditional businesses, all are entrepreneurs because they are seeking to make a profit. The basic question, then, is: What does the American public think of profits and profit-making?

I have outlined briefly some of the hard evidence on which we might base a valid conclusion – public opinion polls, the Acts of Congress supported by the public, the climate of opinion among those who teach in the colleges and those who write for the general public, investment attitudes of the public, and so on. Substantially, this evidence indicates that the man in the street has a rather ambivalent attitude toward the entrepreneur and the vital importance of capital accumulation.

On the negative side is the

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growth of restrictions on entrepreneurial activity. A major influence along these lines has been the teaching and writing of left-wing intellectuals who favor intervention. Inflation also gives a tremendous impetus to restrictive measures. Curbing inflation is essential to perpetuate a healthy free-market system.

On the more hopeful side is the fact that the intellectual left does not have, and never has had, mass support in the United States for a broad-scale political attack on free enterprise. Also, the investment activities of more than 25 million citizens indicate their desire to participate in entrepreneurial activity.

While the progress of interventionist measures may give a feeling of hopelessness at times, it must be realized that the profit system is so powerful that it has, nevertheless, accomplished miracles of capital accumulation and production. It bears the heavy burden of interventionism remarkably well.

Finally, it must be noted, there is a heartening increase of activity by free-market advocates in the academy and in journalism and in politics.

There are fashions in political and economic thinking; and the fashion of the past generation may be altered through education of the American public.

IDEAS ON LIBERTY

In Retrospect

THE ENTREPRENEURS are neither perfect nor good in any metaphysical sense. They owe their position exclusively to the fact that they are better fit for the performance of the functions incumbent upon them than other people are. They earn profit not because they are clever in performing their tasks, but because they are more clever or less clumsy than other people are. They are not infallible and often blunder. But they are less liable to error and blunder less than other people do. Nobody has the right to take offense at the errors made by the entrepreneurs in the conduct of affairs and to stress the point that people would have been better supplied if the entrepreneurs had been more skillful and prescient. If the grumbler knew better, why did he not himself fill the gap and seize the opportunity to earn profits? It is easy indeed to display foresight after the event. In retrospect all fools become wise.

LUDWIG VON MISES, *Profit and Loss*

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For MORAL GROWTH

TIBOR R. MACHAN

THE PHILOSOPHY of freedom has not always fared so well as has the practice of freedom. For instance, the American economic system, flowering under conditions of comparative freedom, has yielded a virtual miracle of goods and services, whereas the political philosophy of liberty – the system's moral framework – has fallen out of favor with Americans. And today's enemies of liberty look at the moral climate and propose that we blame it on America's economic success. They say that the free enterprise system – essentially the voluntary cooperation of individuals in their economic activities – did not and does not work. They attempt to prove this on the grounds that economic efficiency is not served by freedom of production and exchange; but what they are really complaining about is that the free market has not done what it was never designed to do: it has not made everyone morally perfect.

The problem here is a failure to recognize the difference between political and personal behavior. The former has to do with how people should live together in peace, while the latter concerns one's conduct of his own life. An effective political system may be approximated without the guarantee that citizens of the system will all be good individuals. It is precisely so as to secure the possibility for the highest degree of moral development on each person's part that people must be free from each other's aggression.

It is man's personal freedom, his capacity for choice, that forms the philosophical base of the political system we call the free society. If men were not free in this basic sense, they could not help doing what they do; and to expect them to refrain from interfering with each other's lives would be irrational. And so would be the desire for a free society.

A free political society would require some means of protection against those who would trespass upon or attack the lives and properties of peaceful persons. This

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conviction has been the impetus behind people's support for some kind of political system, that is, for the institution of government.

What the enemies of freedom have never understood is that there simply is no political means by which to make people good. A free society does, however, stop those who try to lord it over others. If a culture is morally defective, there is nothing that politically free men can do to induce morality except to educate as energetically and effectively as their talents and devotion to virtue permit. It is a mistake to blame free men for not attempting to make others better through political means: a person who respects freedom cannot aspire to become a philosopher king without contradicting himself; it is illogical to preach that no man should rule others and at the same time attempt to bring about this condition of freedom and virtue by force!

When individuals fail to measure up in moral qualities as is true of many in America today, this means they are acting without questioning what is right or wrong. The idea that individuals can aspire to moral virtue has been down-graded; instead, the collective, the group, the society has been given the responsibility of building the good life. Individualism always has been central to the American economic system, but in matters of personal morality the individual was not widely recognized to have great significance and responsibility. Instead, the community, the church, the body politic assumed the role of moral leadership.

Today, when it is obvious to most that morality cannot be politicalized and that something is drastically wrong, people are rejecting even the possibility of being good. Many college and university students express the view that right and wrong cannot be known; we are capable only of mindless action. Not only students and young people but members of the older generation are generally pessimistic about the possibility of building a better life for themselves and a better society.

Overt enemies of the free society often capitalize on this cultural moral vacuum by attributing it to the relative freedom most people enjoyed in the early days of America and other Western societies which were influenced by the English classical liberal tradition (of Adam Smith, David Hume, John Stuart Mill). By pointing to some of the real and alleged personal failings of people who have been part of the American culture, they would have us believe that there is a necessary

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connection between political freedom and personal misconduct.

There is, of course, a necessary connection between freedom and the possibility of evil, just as there is such a connection between freedom and the possibility of good. But what is important is that both good and evil are matters of personal conduct. No one can make another person good or evil. Harming someone who is good will not make him evil, nor will helping an evil person make him good, in the final analysis. Praise and blame, reward and punishment, are all responses to good and evil, but they are not primary causes.

Those who contend that the free society is bad for people, because people who have been free did not always behave well, are mistaken. It is, in fact, only in a free society that the wrongheadedness, the personal mischievousness of some people, does not necessarily have a harmful effect on all. In socialism, where everyone has a hand in the life of everyone else, the evil that men do must live after them — and beside them, and around them, and on and on. The mismanagement of some collectivist government project burdens us all. Nor is it possible to uncover those who are responsible for the mismanagement. The abandonment of self-responsibility in favor of collective action invariably spreads the lack of responsibility throughout society.

Today, in a climate of fear and moral uncertainty, unscrupulous persons make all sorts of attempts to gain political power over people. Their arguing that the free society and the corresponding free market produce human evil must be challenged. A free society may not produce everything that everyone would like; but free men have the option to pursue their own goals and aims. When there is no freedom, a person cannot even aspire toward satisfying his aims privately. When one's life is controlled by political masters and things are going badly, there is little personal incentive toward improvement, and understandably so. But in freedom, one man's efforts suffice to make his own life, at least, more productive or otherwise worth while. And this may encourage others to do likewise.

To try to improve the quality of life in a given society by centralizing it under political leadership is futile. Such efforts simply diffuse responsibility and reduce the likelihood of moral improvement. Needed, instead, is a concentrated effort to restore to people both their rights and their responsibilities. Those who value human life and look for it to be lived well should encourage progress toward a free society.

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CLARENCE B. CARSON

Throttling the Railroads

6 In the Grip of Government 1920-1958

IF SOMEONE had set out with malice aforethought to destroy the effectiveness of the American railroads, he could hardly have devised better ways than those employed by the Federal government for much of the twentieth century – short of hiring wrecking crews to take up the track and dynamiters to blow up the rolling stock. Before World War I, the government subjected the railroads to increasingly debilitating restrictions: by trying to use force to make them compete, not permitting them to compete in many of the usual ways, making it difficult for them to cooperate and coordinate their activities, freezing the systems into their earlier patterns, prohibiting them to follow certain practices by which they could profit and serve consumers, prescribing uneconomic practices, driving investors away and, perhaps unintentionally, promoting the dissipation of working capital.

Having so circumscribed the railroads as to make it virtually impossible for them to adjust to new demands and changing conditions, the government took over and ran them during World War I. The railroads were technically returned to their owners after the war, but this was done in such a way that the death grip upon them was retained if not actually tightened. While the railroads

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were bound hand and foot, as it were, government subsidized and promoted alternative means of transport and facilitated the unionization of their employees against them.

Indeed, if railroad managements had been dangerous criminals with lengthy records of dastardly acts, they could hardly have been more carefully watched and had their activities more extensively limited and restrained. In fact, railroad men were treated as second class businessmen, as charlatans ready at every moment to cheat investors, as extortionists ready to take unfair advantage of customers, as conspirators eager to beset the public, and as brigands on the march to destroy American transport. From another angle, railroaders were treated as if they were truant children whose every activity must henceforth be minutely supervised and whose dealings must be subjected to the most searching scrutiny. In short, men who undertook to operate railroads were, in that capacity, virtual prisoners of their own government.

However, it would be an error to suppose that those directly connected with the operation of the railroads were the primary victims of these government policies. Railroad executives have no doubt generally enjoyed compensation and prestige similar to their counterparts in other industries. Supervisory personnel must have had good salaries over the years. Employees of railroads have usually received relatively high wages. Even stockholders have frequently received dividends and bondholders been paid off. The primary victims of government intervention in the operations of the railroads have been consumers – all of us – who have been denied the best goods at the lowest prices and passenger service of high quality at low prices which they might have otherwise had. It is probably impossible for governments to follow policies that will induce businessmen to serve without compensation, but it is easy to devise policies which result in losses to consumers. This has been the result of the government's regulation of the railroads.

The Socialist Attack

Back of these policies was socialist doctrine, as was indicated in an earlier chapter, however revised and watered down that doctrine might be when it reached the popular mind. More than anyone else, it was socialists who conceived of businessmen as villains preying on the public for private gain. To them, private enterprise was irredeemably flawed by the selfish quest for gain. The rail-

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roads received the full brunt of the earliest socialist assault against private enterprise in America. It does not follow, of course, that all who favored regulating the railroads were socialists. Much of the animus for regulation can be accounted for by special interests wishing to use the railroads for their particular advantage. But socialism provided the ideological ammunition – the animosity toward private business, the notion that service should be divorced from profit, and the statist assumptions held by regulators – and the protective coloration for these special interests.

More important, socialism provided a direction and a goal for regulation. The ultimate professed goal of socialists was government control of the railroads and their use for the benefit of the people. Two means to this end have been set forth. One is the government ownership and operation of the railroads. This is the way of what are now sometimes called *doctrinaire* socialists. The other way is more subtle and indirect; it involves government control without ownership and entails a variety of means. This is the way of *pragmatic* socialists. They do not ordinarily refer to themselves as socialists at all in the United States; they prefer to be known as pragmatists, liberals, or some such euphemism. But from the direction of their thrust it can be determined that they are socialists, regardless of the name by which they are known.

Pressure Toward Government Ownership and Operation

Up to and through World War I the pressure of socialists was toward government ownership and operation of the railroads. This was true of several third parties which did not identify themselves as socialists as well as the various avowedly socialist parties. Herbert Croly, a "progressive" socialist, indicated how the goal might be achieved in what he wrote a few years before World War I:

> In the existing condition of economic development and of public opinion, the man who believes in the ultimate necessity of government ownership of railroad road-beds and terminals must be content to wait and to watch. The most that he can do for the present is to use any opening which the course of railroad development affords, for the assertion of his ideas; and if he is right, he will gradually be able to work out, in relation to the economic situation of the railroads, some practical method of realizing the ultimate purpose.[1]

[1] Herbert Croly, *The Promise of American Life*, Cushing Strout, intro. (New York: Capricorn Books, 1964), p. 377.

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Regulation set the stage for a government takeover by making it increasingly difficult for the railroads to do their job effectively. World War I provided the crisis which was used as the occasion for government operation of the roads. A major propaganda effort was made during and immediately after World War I to make the takeover complete and permanent. This campaign did not succeed; it was thwarted by a Congress determined to return the railroads to their owners.

It turned out, however, that only doctrinaire socialism was rejected. American reformism had taken its own peculiar form. Instead of going from operating them to government ownership of the railroads, the government abandoned both of these and turned to full-fledged control. It was sufficient for the day that government have power, authority, and control over the railroads. Progressivism had prepared the way for this direction to be taken. Politically, such a direction is clearly superior to ownership and operation. When government owns and operates, bureaucrats must take on onerous duties and responsibilities; they must provide the services and get the money for operation. Control without ownership provides the bureaucrat with power over but little, if any, responsibility for rendering services. At any rate, this is what was established for the Interstate Commerce Commission in the 1920's.

Regulated Out of Service

It was about as clear as such things can be that when World War I came the government restrictions made it virtually impossible for the railroads to provide the desired services. A railroad historian has recently observed that the "poor condition of the rail lines in 1917 was no doubt partly the result of earlier excessive or mistaken regulation. . . ."[2] Even the Interstate Commerce Commission's recommendations at the time indicated an awareness of the debilitating impact of the restrictions. The Commission recommended that the government either take over and operate the railroads "or that all legal obstacles to the complete unification of the railways for that period be removed. . . ."[3]

Once in power over them, the government reversed its former policies toward the railroads. What was sauce for the private enterprise goose definitely was not

[2] John F. Stover, *The Life and Decline of the American Railroad* (New York: Oxford University Press, 1970), p. 175.

[3] Sidney L. Miller, *Inland Transportation* (New York: McGraw-Hill, 1933), p. 156.

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sauce for the government gander. William G. McAdoo, who was placed in charge of the railroads, proceeded to do all sorts of things that had been either prohibited or beyond the power of rail executives. Rail service was speedily coordinated; the railroads were treated as if they were a single system. Freight was routed the shortest way. The government discriminated vigorously among shippers, giving war goods preference. Passenger service for the general public was greatly curtailed. The railroads had for several years been denied any significant rate increase. "Under the Federal Control Act it was unnecessary to secure the approval of either state or federal regulatory bodies for changes in rates. . . ." New rates could simply be proclaimed: thus, "the Administration announced, on May 25, 1918, a 25 per cent increase in freight rates effective a month later. . . ."[4] Of course, the government was free also of antitrust restrictions and could and did treat the railroads as a giant trust.

Even so, the railroads were in bad shape when they were returned to their owners in 1920. McAdoo and his successor had seen fit to accumulate a huge deficit rather than raise rates sufficiently to cover costs. "The official report of the Railroad Administration admitted that the total operating expenses (plus rentals paid to the individual railroad companies) exceeded total revenues for the twenty-six months of federal operation . . . by just over $900,000,000."[5] And this figure does not include more than $200 million later paid to the railroads for undermaintenance during the war. This latter figure, however, amounted to only about one-third of what the railroads claimed they were due for undermaintenance. The railroad owners were stuck with an inheritance of high wages to employees, excess equipment constructed for wartime purposes, and roads that had generally been run down.

The Transportation Act of 1920

Had the management of the railroads been left free to operate them as they saw fit, they might have been able to revive the roads. They were not. Instead, they were much more completely shackled than ever by the Transportation Act of 1920. This act should be considered the crowning piece and culmination of Progressive legislation. The agitation of the Progressives produced antitrust activity, a spate of legislation, several constitutional amendments,

[4] *Ibid.*, p. 163.

[5] Stover, *op. cit.*, p. 173.

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and heady intervention in foreign affairs. By the end of World War I, or before, it appeared to have lost its impetus. Americans were weary of reform and were registering their feelings at the polls. Even so, one more piece of Progressive legislation was pushed through, one which was typical of what Theodore Roosevelt had advocated as the Bull Moose candidate in 1912 – that the government leave property ownership in private hands but subject the great industries to stiff regulation. Of course, Roosevelt supposed that the railroads were already so regulated, but the principle which he would have applied to all industry was carried to its logical conclusion in the Esch-Cummins Transportation Act.

Much early policy was reversed. The Interstate Commerce Act had prohibited pooling. The Transportation Act of 1920 authorized the Interstate Commerce Commission to approve pools if it could be shown that they were in the public interest. Antitrust legislation had been aimed at one corporation indirectly controlling others. The new act authorized the Commission, "upon application by any carrier or carriers and after hearing, to approve 'the acquisition . . . by one of such carriers of the control of any other such carrier or carriers, either under a lease or by the purchase of stock or in any other manner not involving the consolidation of such carriers into a single system for ownership and operation,' upon such a basis as may be found by that body to be just and reasonable."[6]

Planned Consolidation

The Act charged the Commission with the task of preparing and adopting "a plan for the consolidation of the railway properties of the continental United States into a limited number of systems. In the division of such railways into such systems under such plan, competition shall be preserved as fully as possible and wherever practicable the existing routes and channels of trade and commerce shall be maintained...." To make it possible for this to be accomplished, the act permitted the Commission to authorize consolidations of railroads into single corporations according to the master plan.[7] Actually, the Commission have never put any such plan into effect. They are waiting, no doubt, until mathematicians square the circle before undertaking so forbidding a task as this.

No longer was it legal for anyone to build or extend a railroad at will. The act required that a

[6] Miller, *op. cit.*, p. 175.

[7] All such authorized actions were specifically exempted from antitrust suits.

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prospective builder must first have a "certificate of convenience and necessity" from the Commission before beginning construction. Moreover, the law provides that "no carrier . . . shall abandon all or any portion of a line of railroad or the operation thereof unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity permit of such abandonment."

The restrictions on railroad finance were equally restrictive. Following a brief period of grace after the act went into effect, "no securities might be issued legally by any carrier subject to regulation except upon Commission approval."[8] The act lays down the general principles upon which such approval may be granted. It notes that Commission approval does not in any way imply that the United States government guarantees such securities. The only securities a railroad might issue without Commission approval would be notes maturing within two years and even such borrowing was restricted to 5 per cent of the par value of outstanding securities.

Rate Control

The most amazing provisions of the Transportation Act of 1920, however, were probably those having to do with rates. The Commission was authorized to fix rates for roads under its authority according to how it grouped them from time to time. The rates were to be fixed so as to assure a fair return upon investment if the railroad were efficiently run. Initially, Congress declared that a fair return in most instances would be 5½ per cent annually of the aggregate value of railway properties. Any railroad that earned more than 6 per cent on the aggregate value of its properties in a given year was to have one-half of the excess placed in a reserve fund for its own future use and the other one-half to be turned over to the Commission to place in a general contingency fund to aid ailing railroads. What was involved was a most complex limitation on earnings and a redistribution plan.

There were several other rate provisions of the act. The Interstate Commerce Commission was granted virtual pre-emptive authority over rates so far as state regulatory bodies were concerned. If it found that state regulations occasioned any prejudice or inconvenience to interstate commerce it could negate them. For the first time, also, the Commission was empowered to prescribe minimum as well as maximum rates. It could also prescribe the division of joint

[8] Miller, *op. cit.*, p. 177.

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rates between or among two or more carriers if it found the prevailing division to be unjust. The long and short haul clause was altered so as to further limit the exemptions the Commission could grant from its provisions.

Routing and Service

The Commission was granted extensive powers over routing and service. A carrier found "improperly" diverting traffic from another line would be liable to the extent of paying the whole amount gained to the "injured" railroad. The Commission was authorized to divert traffic to other lines if, in its opinion, a road was unable to provide a service. Moreover, the Commission was empowered to determine what routes interchanged traffic should take. Should car shortages develop, the Commission could direct their disposition so as to relieve the difficulty without regard to the desires of the owners. The law provided that it should be the duty of every carrier "to furnish safe and adequate car service and to establish, observe, and enforce just and reasonable rules, regulations, and practices with respect to car service." Nor was the Commission to be particularly concerned about private ownership of terminals and surrounding trackage. If the Commission should find that it would be in the "public interest," "it shall have the power to require the joint or common use of terminals, including mainline track or tracks for a reasonable distance outside of those terminals. . . ."[9] The owners were to be paid something for such usage, of course.

Certain of these provisions have been altered over the years. The Emergency Railroad Transportation Act of 1933 attempted once again to effect consolidations of lines into larger and more stable systems. The attempt to prescribe earnings precisely had already been more or less abandoned. The Transportation Act of 1940 placed restrictions on competitive modes of transportation. But the government grip upon the railroads by way of the Interstate Commerce Commission has generally remained. That hold was authorized and established by the Transportation Act of 1920, and its provisions amply illustrate the extent of the grasp.

A state of organized irresponsibility was established by this legislation. The power to make managerial decisions of wide and determining scope was vested in the Interstate Commerce Commission. The responsibility for operating the railroads remained with private management. But that management was denied the authority

[9] *Ibid.*, p. 182.

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to make on its own all sorts of decisions by which entrepreneurs ordinarily operate businesses efficiently and successfully. Rail executives could not, and cannot, buy, sell, build, abandon, or dispose of their facilities without Commission approval. They could not sell stock to raise new funds nor consolidate with other lines without the authorization of the ruling government body. In most of the usual ways, railroad managers could not compete with rail or other modes of transportation, could not compete in price, in supplying of certain kinds of service, or even, if the Commission so ruled, in the exclusive use of better located facilities.

No Room to Operate

Critics of railroad management have long claimed that those running the roads were cautious, unimaginative, disinclined to innovate, and lacking in vision. In view of the limitations under which they operate it would hardly be surprising if the charges were, in substance, true. Any new service innovation could be quite expensive to the railroad. It might not pay off, yet the road might be stuck with providing it indefinitely because the Commission decided that the "public interest" required it.

The crucial factor in explaining the "unimaginativeness" of rail management, however, is the tying of rate structures to earnings. When this is combined with government engendered inflation – that is, increase of the money supply – as it usually has been since 1920, it is easy to understand why managements have been reluctant to make daring innovations. Increases in money supply mean that prices in general must rise to offset the increase. Yet railroads have to observe a time lag before they can raise their prices, if it turns out that they are permitted to do so. To get the raise, they need to demonstrate that their earnings are insufficient under the present rate structure. The effect of this is that railroads can rarely expect to turn a good profit by extending services, but they can lose a great deal. In short, railroads cannot – under inflationary conditions – make much of a profit; they can, however, have horrendous losses.

Actually, however, rail executives have often been quite imaginative. They have even made interesting service and equipment innovations from time to time, but that is not what I want to point out here. Much of the managerial imagination has not been expended in finding ways to improve and expand service, as it normally would be. It has, instead, been de-

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voted to finding ways for a railroad to survive and make a modest profit under the crushing burden of restrictions, to finding ways to circumvent the thrust of regulation, and to finding arguments and evidence to convince the Commission to permit some course of action.

Holding Against Disaster

Railroad men have fought a fifty-year-long holding action against disaster. Denied most of the avenues by which they might advance, they have husbanded their resources by strategic retreats. They have developed ingenious arguments supported by voluminous arbitrarily construed statistics for reducing services — for dropping passenger trains, for cutting off dining cars, for closing depots, for not installing warning systems, and so on. They have become, in effect, *un*businessmen, for rather than seeking to expand services, they have sought to reduce them; rather than increasing traffic, they have sometimes sought to reduce it; rather than reduce prices to increase the number of customers, they have often sought to raise prices and have thereby reduced customers and revenue.

These unbusinesslike actions make sense only in the framework of restrictions that has been erected. The reversal of priorities from expanding services through innovation to reducing services can be explained, and the explanation will show that it was about as good business as could be done. Denied much expectation of profits by new exertions, railroad men turned to making what profits they could by as little effort as possible. They sought to keep only that business which was most profitable, involved the least risky outlay of funds, and entailed the least amount of effort to acquire and service. They sought to use the rails where they were most clearly superior to other modes of transportation and to avoid competition where superiority was less certain.

Under such policies, the railroads ceased to be a growth industry. Indeed, they appear to be an industry dying of a lingering illness. One after another they have abandoned or had taken from them services that they once performed: the carrying of mails, the hauling of most packaged freight, much of the passenger service, and so on. Each time a railroad lops off or reduces service to an area it is apt to reduce the number of customers for even its profitable traffic. For example, when passenger service to a small community is discontinued, it reduces the likelihood that people travel-

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ing at however great distances will go by train when either their point of departure or destination is that city. Cut off enough such service and even long distance trains between great cities will not have enough passengers to warrant the provision of the service. The same principle will generally hold regarding any such service, and the railroad policies have undoubtedly produced the appearance of a dying industry. These policies, in turn, have been the result of desperate measures taken by railroad men caught in a stranglehold by the Interstate Commerce Commission.

Had this been all, the railroads might still have held their own. But there was more. They were faced by increasing competition from other modes of transportation. And while they were being circumscribed by onerous restrictions, governments were frequently aiding and abetting their competitors. That part of the story needs also to be told.

Next: The Grip of Privileged Competitors

FREEDOM AND DEMOCRACY

EARL ZARBIN

A COWORKER, assigned to write a newspaper story about Independence Day talks in Arizona, opened with this sentence:

"Lawmakers and political figures beckoned back to the first Fourth of July in talks throughout the state yesterday with the message that democracy is hard to come by and even harder to maintain."

Mr. Zarbin is a newspaper man in Arizona.

This linkage of the word "democracy" with the Declaration of Independence surprised me. When I asked if the word "freedom" might not be more correct, he replied: "I didn't think about it that much when I wrote it."

Precisely. Seldom do we think about it. Woodrow Wilson said, "The world must be made safe for democracy." Would it have made

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any difference if he had used "freedom" instead of "democracy"? Perhaps not, but it is delusion either to suggest or to believe that the words are alike in meaning or significance.

Freedom is "the absence of necessity, coercion, or constraint in choice or action; liberation from slavery or restraint or from the power of another." Democracy is "government by the people; especially rule of the majority; a government in which the supreme power is vested in the people and exercised by them directly or indirectly through a system of representation usually involving periodically held free elections."

In no way can the words "freedom" and "democracy" be substituted without confusion. That they are frequently used for one another is understandable. Democracy, not freedom, is repeatedly held up to us as representative of the ideal. If we have democracy, we are presumed to have freedom, according to much of the oratory.

But we can – and do in fact – have denials of freedom brought about by democratic or majority rule. Prohibitions against peaceful citizens entering peaceful occupations and pursuits abound. For instance, no one can open up new land to cotton without an allotment; no one can start a radio or television broadcasting station without approval. Instead of relying upon market determination of approval or allotment for every honest enterprise, all too often permission from government must first be won. And there are countless examples of how such economic freedom has been denied under democracy.

Freedom is one thing, democracy another. They may be related in some ways. But the concepts are not interchangeable, nor should the nature and purpose of the two be confused.

IDEAS ON LIBERTY

Loyalty

IF YOU WORK for a man, in Heaven's name work for him; and stand by the institution he represents. Remember – An ounce of loyalty is worth a pound of cleverness. If you must growl, condemn, and eternally find fault, why – resign your position and when you are on the outside, damn to your heart's content – but as long as you are a part of the institution, do not condemn it. If you do, the first high wind that comes along will blow you away and probably you will never know why.

— ELBERT HUBBARD

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CARTE BLANCHE FOR CHAOS

LILLIAN R. BOEHME, the editor of a monthly magazine called *The Libertarian,* likes to write with a double focus. It is a difficult trick, but she pulls it off in a searching, closely argued book called *Carte Blanche for Chaos — a Critical Look at the Kerner Report* (Arlington House, $7.00).

On one level this is a "news" book. It goes rather exhaustively into the findings and recommendations of the National Advisory Commission on Civil Disorders that tried to get to the bottom of the urban rioting and arson that began in the Watts area of Los Angeles and spread throughout the land for several of those "long, hot summers." But behind the critique of the news there is another and far more positive book of a kind that would have appealed to the late Isabel Paterson or the late Rose Wilder Lane. Mrs. Boehme is not only concerned with exposing the statist bias of the members of the Kerner Commission, she is also concerned with enunciating the principles of what Leonard Read calls "the freedom philosophy." The Kerner Commission's performance is the occasion for Mrs. Boehme's work, but she could have done just as well if she had picked any one of a number of recent "official" investigations such as the Scranton committee's probing into the causes of campus violence. With Mrs. Boehme it is the application of her own ideas that counts.

Briefly, Mrs. Boehme has it in for the Kerner Commission for being part of the disease which it was supposed to anatomize and to cure. The men of the Commission blamed the urban riots on "racism." The theme, as stated, is that the "needs" of the rioters and arsonists, mostly black because of the geographical focus of the Report, constitute a set of "rights," and the fact that the "needs" had not been satisfied over the centuries was enough to

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justify or at least to excuse all manner of violence. "Society" is the guilty party according to this way of thinking. The victims of the rioters, so the Kerner philosophy assumes, are necessarily to blame for their own injuries, despoliation, and deaths. For they had done nothing to meet the "needs" of their tormentors and murderers.

This, of course, is a jungle philosophy. It makes hunger an excuse for taking the property of the person next door. It does not recognize the individual nature of "rights," which must be considered anterior to the institution of government if we are not to confuse them with permissions or gifts or dispensations or privileges.

With their peculiar view of the nature of "rights" it is scant cause for wonder that the men of the Kerner Commission forgot to look at the victims of the rioters. Mrs. Boehme says that "people whose homes had gone up in flames, small shopkeepers whose stock vanished in the arms of looters, were not heard.... The 'antagonistic views' of the victims of violence were deemed irrelevant to the Commission's quest."

Mrs. Boehme does not deny that life, in a slum, can be hard. But it does not follow that just because the "nonproductive" are poor, the productive are guilty of "depriving" them. The only way in which the poor can be upgraded is to let the producers go to work producing more, for without an expansion of the economy there can be no jobs for the "needy" who have not succeeded in finding berths within the productive system. Even the taxes that go for "relief" in the slums are dependent on prosperity outside the slums.

In a devastating summary Mrs. Boehme says the Kerner Report claims to defend human rights by obliterating the very concept of rights. The Report treats "needs" as rights to what other men produce. It deplores violence – and proposes to institutionalize it by laws that justify the forcible redistribution of other people's property. It preaches against racism, but it judges all individuals in racist terms (it is "they," the Kerner Commission members, "who cannot see or write of a man without referring to his color.") The Commission speaks of justice, yet it proposes that the victims of the rioters be forced to pay for swimming pools, rat poison, schools, and even garbage pails for those who have burned the shops and stolen liquor and TV sets. Praise for "law" may be found in the Report, but it goes on to make out a case for the thief

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who shoots a policeman in "self-defense." The Report is all for "freedom" of thought – but it offers sneaky justifications for shaming the press into self-censorship, and it advances proposals for state manipulation of the thoughts and actions of men. Finally, the Report is anticapitalistic. It makes "incompetence the coin of the realm." It proposes that the plight of the unemployed be alleviated by passing more "laws to make employing them uneconomic." It sets up the "have-nots" as the judges of the "haves," which means that investment capital can be seized before it has made a single new machine or built a new factory. It praises "free enterprise," but recommends "a fascist system of nominal private ownership castrated by statist controls."

The Underlying Philosophy

If I have any criticism of Mrs. Boehme's book it is that she doesn't tell us enough about the statist philosophers of the nineteen thirties who created the modern slums, miscalled ghettoes, in the first place. The reason why the blacks took up a forced march into Harlem and Watts, into Brooklyn's Bedford-Stuyvesant and Detroit and the Chicago South Side, is that the New Deal attempt to cure the woes of American agriculture by subsidies to the richer farmers ended by "tractoring the field hands off the land." The money the cotton planters got for limiting their productive acreage went into high-priced mechanization at a much faster pace than would have occurred naturally if "market" principles had been permitted to operate. What would have been an orderly transition, with factories moving into the South to employ stay-at-home labor displaced from the farms, became a rout. The blacks, faced with the necessity of finding new places to live, moved into northern city areas that were already being deserted by whites who could afford to take up new homes in suburbia. New Deal statism was at the bottom of the congestion that occurred over the years.

Since statist ideas are responsible for the overcrowding in places like Watts, I am more inclined than Mrs. Boehme to be lenient with the businessmen who have tried to do something about training and employing the so-called "hard core." Mrs. Boehme criticizes the Lockheed Corporation's program for putting Watts people to work in the factory it has built in the Watts Industrial Park. And it is true that the practice of setting up "negative" standards (such as being a school dropout or a person with a criminal

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record) for employment has its ludicrous aspects. But when the Lockheed company says that "none of these requirements is so difficult as to present a significant obstacle to the normal profit function," shouldn't we be willing to accept the explanation if the stockholders approve? The state itself forced man off the land into the slums, leaving a problem of mopping up to somebody. So why object if businessmen volunteer to do the mopping?

▸ THE THEORY OF EDUCATION IN THE UNITED STATES by Albert Jay Nock (New York: Arno Press, 1969, 160 pp., $6.00).

Reviewed by Robert M. Thornton

SOME EXCELLENT books and essays on education have been published during the past twenty years — most notably those by Jacques Barzun, Mortimer Smith, Richard Weaver, Bernard Iddings Bell, George Roche, R. J. Rushdoony, and Christopher Dawson. There were earlier critics and one of the most perceptive was Albert Jay Nock whose *The Theory of Education in the United States* has been republished. This volume is made up of the Page-Barbour Lectures delivered at the University of Virginia in 1931. First published in 1932, it was republished in 1949 and has for a long time been out of print and very hard to come by.

Much of the criticism directed against modern education, while worth while and true, does not go deep enough. But Nock, the radical thinker, put his finger on the root of the matter: the faulty theory of education which guides most educators in this country. Stated briefly, this theory declares that (1) all persons can be educated; (2) all persons should be educated; and (3) universal education will bring us a much improved society. Part one is, of course, false because not all persons are educable any more than all can run a mile in four minutes or write a best-selling novel. This was recognized at about the turn of the century by the powers that be but instead of discarding a worthless theory, they substituted training for education. Nearly everyone may be trained to do something whether it be driving a truck, performing a surgical operation, or programming a computer. Training has to do with instructing or "putting in" information and is concerned with instrumental knowledge, with vocationalism or how to earn a living. Responsibility falls chiefly on the instructor.

Education, on the other hand, is a drawing out process that has to do with formative knowledge, with how to live. Responsibility, of

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course, rests with the student. "Education," wrote Nock, contrasting it with training, "contemplates another kind of product; what is it? One of the main elements in it, I should say, is the power of disinterested reflection. One unmistakable mark of an educated man is his ability to take a detached, impersonal, and competent view of something that deeply engages his affections, one way or the other — something that he likes very much. The study of history has really no other purpose than to help put this mark on a man. If one does not study it with this end in view, there is no use studying it at all."

Training we need, especially in this age of a rapidly expanding technology, because we need practical know-how to provide our economic needs and wants. But we need "useless knowledge," too, because that is what civilizes us. Education, rightly so called, has suffered a terrible decline in our time, because we have operated for several generations on a skewed theory which confuses education with training.

Part two of the theory is unacceptable to those who recognize the error in part one. Those who have not recognized it are responsible for making our school system (outside of private and parochial schools) compulsory both as to support and attendance, a situation not unpleasing to the collectivists who labor for the creation of an all-powerful state. The problems created by the application of this false theory are serious: rising taxes, crowded classrooms, shortage of qualified teachers, decline in the quality of schools, the trend toward Federal control of local schools, student riots, and lawbreaking.

Part three of the theory of education embodies the idea that "education" can solve all the problems of the world. This is, of course, a delusion even if we were speaking of true education and not training. Even if everyone were educable, universal education would not bring about a utopia. It is not simply a lack of knowledge and wisdom that is responsible for poverty, prejudice, and war; these stem from the very nature of man as a flawed creature. One might even say that training passed off as education is making things worse.

The responsibility for the deplorable state of education today "lies nowhere in the order of our institutions; it runs back to the acceptance of an erroneous theory. All this ludicrous state of things that we have been examining is the inevitable result of trying to translate a bad theory into good practice."

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▸ THE BRITISH NATIONAL HEALTH SERVICE: *Bad Medicine, Bad Politics, Bad Economics* by Michael R. Saxon, M.D. (The Saxon Foundation; 143 S. Lincoln Avenue, Aurora, Illinois 60505) 1970, 61 pp., paper, $1.75.

Reviewed by W. M. Curtiss

THE 22-year-old British National Health Service is pronounced a failure by Dr. Saxon. He says it presently encompasses about 95 to 97 per cent of all the health services in the United Kingdom. "To a sensitive practicing physician alert to the current trends of socializing American medicine, the British system offers much to observe and compare with an ever-expanding government-sponsored health service scheme inaugurated in America in July of 1965 [Medicare]."

Dr. Saxon discusses the familiar shortcomings of the NHS – the high number of patients per doctor (2,500 average); the low income of doctors resulting, in part, in their great exodus from the islands; the inadequate hospital facilities; the suffocating effect on medical research; and, of course, the high cost covered through taxes. General practitioners say they have become second-class doctors.

English socialists have claimed that their system shows a special compassion in understanding the needs of the poor and the sick. This strikes an exposed nerve in Dr. Saxon who believes that the truth is exactly the reverse. American doctors, practicing in a market economy, can express compassion for their patients; whereas British doctors, in attempting to treat all patients alike, feel little need for compassion and have little time to demonstrate it.

To offer medical care to all on an equal basis and at little direct cost has popular appeal, and plays right into the hands of politicians. Dr. Saxon believes this an important reason why socialized medicine has progressed so far in the United Kingdom. But how many doctors will say, with Dr. Saxon, that: "It can hardly be said that medical care is really a necessity. Food, clothing, and shelter are even more fundamental to human existence than medical care and are supplied satisfactorily through the market place. . . . The constant search for profits as one delivers a needed service to the market, creates a competitive atmosphere wherein the consumer always gets the most for the least. Why then is medical care different?"

Dr. Saxon obviously wants us to learn from the British experience.

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